The Canadian Chartered Accountant

- **Management Accounting in the United States**
  By Lloyd O. Morley
- **Professional Accountancy**
  By Kenneth F. Byrd
- **Formal Education and Internal Auditing**
  By S. G. Hennessey
- **Postponing Taxation by Incorporating a Business**
  By W. G. Leonard

THE TAX REVIEW

MAY 1954

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SWEETNESS and LIGHT

By Jay Vee

A Narrow Escape

THERE used to be a song about Toronto which began "*T* is for the terrific traffic troubles", but it isn't popular any more. True, when its subway first went into operation under the main street there were many doubting Thomases. One midtown dry-cleaner was skeptical enough to put a sign in his window which told the passerby: "You take the high road and I'll take the low road and I'll be at Queen Street before you — MAYBE". And a fair number of male passengers during the first few days supplied themselves with stop watches which they pulled out and studied intently each time the train came to a station. But in spite of their assured predictions it soon became apparent that there really was going to be a marked improvement in Toronto's transportation services.

Now this turn of events put Torontonians in a very embarrassing situation. You see, for years much of their casual conversation and many of their forms of greeting had revolved around complaints about the Toronto Transportation Commission and its services. It was almost a trademark. They say that it is easy to spot a Calgarian keeping a date with a friend by the way be breezes up, claps his hand on his pal's shoulder, and bellows "Hiya!" On the other hand, a Montrealer is distinguishable by his sophisticated little nod and clearly pronounced "Good evening, John".

Sweetness and Light

But for the true native of Toronto it was always *de rigueur* to race up about 10 minutes after the appointed hour and wearing a scowl of righteous indignation, splutter "That darn streetcar!" into the face of his waiting companion. And now, alas, rapid transit was to deprive him of his traditional excuse.

In like vein, office workers going up on the same elevator used to compare notes as to whether one car-line was worse than another, and thus new friendships were formed. Sometimes two complete strangers, annoyed by a long cold wait at a bus stop, would voice their disgust to each other and soon be engaged in lively chatter. But now with buses pulling up on time in front of indoor stations, there was nothing to say. Surely the outlook was bleak, and nary a cheering gripe to fall back on.

The loyal citizens of the Queen City, however, soon saw the need and rallied to the cause. Gripes just had to be found and found they were. Here and there at first, then swelling in size through letters to the papers, and finally given recognition by City Council, they offered satisfaction to even the most fastidious critic. Here are a couple of samples which we overheard recently:

"What, *me* walk up and down all those stairs? When they first started that subway they told us we would just step from the bus to the train, and they didn't keep their promise." (It does seem that the escalators are always running the opposite direction from the way we are going, we must admit.)

"That pit is awfully dangerous for children. I'd be afraid my two would fall in if the platform got crowded." (Here again we have to agree that an appalling number of boys between 8 and 80 do hang over the edge to watch the train emerge from the tunnel. The

Sweetness and Light

first tilts his head just slightly, the second leans over beyond him, the third has to bend at an angle of 90°. Any day now we expect to see a lad stretched out horizontally across the pit while his chums hold on to his ankles.)

The other complaints, concerning narrow exits, greater walking distances, etc., have been equally well supported and are now woven into the fabric of Toronto conversation. So the gap has been filled and you will be glad to know, dear reader, that today the citizenry faces the future with confidence, safe in the knowledge that it still has something to chew about after all.

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COMMENT AND OPINION

Retirement Pensions: The Tucker Committee Report

IN February last the joint taxation committee of the C.I.C.A. and the Canadian Bar Association renewed their perennial submission to the Minister of Finance for the deferment of income tax on the contributions of self-employed persons towards the provision of retirement pensions. Mr. Abbott's response to that request will be known by the time this note appears, and it is hoped that he will be less obdurate than in the past and find the difficulties which he mentioned last year not insuperable after all. It may not be without point that the Millard Tucker Committee on Retirement Pensions, in its report made public in February, found itself able by a majority to recommend the establishment of such a policy for the United Kingdom, and even the minority concurred so far as members of professional societies were concerned.

Revision of U.S. Income Tax Law

A THOROUGHGOING revision of the U.S. Internal Revenue Code has been proceeding through the legislative mills of Washington for some time now, and unless an unexpected reversal of front occurs it will, when enacted, represent something of a triumph for accounting principles and the accounting profession. About two-thirds of the recommendations made by the American Institute of Accountants have, we are informed, been incorporated in the Bill which was introduced. Some of the proposed changes are already familiar in this country, notably the partial removal of double taxation of corporate profits through the grant of a tax credit for dividends received, and the right to claim depreciation on the declining balance method using a rate two times the straight-line method, together with some relaxation of the rigidity of the rate structure. Many other of the proposed changes in the American tax law would, however, be equally desirable here.

The joint taxation committee of the C.I.C.A. and the Canadian Bar Association in their brief to the Canadian Government urged that the rules governing the deductibility of business expenses should be broadened and, in general, that if an expenditure is incurred for business purposes it should be deductible in computing the profits of the business, either in one year or, where applicable, over a period of years, and the Government was also urged to reverse its policy in regard to so-called "reserves" and in effect to assimilate the tax treatment to the accounting treatment of prepaid income and provisions for future costs. The American Institute made similar recommendations to the U.S. authorities and

in both respects it appears that their efforts have been more successful than our own have so far.

Thus, we understand, the revised U.S. Code will permit research and development expenses to be deducted in the year they are incurred or amortized over a period of five or more years, and expenses of organizing a corporation to be similarly amortized over a period of years. Provisions or "reserves" for estimated expenses are to be deductible if reasonably capable of being estimated, for example, reserves for cash discounts against outstanding receivables, for product guarantees, for vacation pay, for self-insured cargo claims pending, for cost of handling, packing, and shipping merchandise sold but not delivered, etc. Prepaid or unearned income will not, as here, be required to be reported when received subject to a deduction for certain future expenses, but can be reported as and when earned within a five year period following the year of receipt. Prepaid amounts are deemed to be earned as the liability to render services, furnish goods, or allow use of property is discharged.

We must add that at this writing the above are merely proposed changes, but there appears to be every likelihood that they will be passed into law.

Inventory Valuation for Tax Purposes

AN interesting judgment on the subject of inventory valuation in the tax law was recently pronounced by the Court of Appeal in England, which will almost certainly exert an influence on this side of the Atlantic. The question at issue was whether a cotton spinning company was entitled to employ the base stock method for the cotton on its machines in computing its trading profit for the year, that is, treat the cotton on the machines as part of the machines and not as an inventory item. It was not in dispute in that case that the base stock method was a recognized method in the cotton spinning trade, that it was in accordance with sound commercial practice and that the method of computing a concern's profits by that system was in accordance with sound commercial practice. In spite of these undisputed findings, the trial Judge and the three Judges of the Court of Appeal were as one in holding that if that system did not give the true profit of a concern for the year under review it was not an acceptable method for tax purposes, and in the particular case since both the quantity of the base stock had increased during the year and the price of cotton had risen during the year there was no doubt that this condition was not satisfied.

The Court held that in computing profits for a year the closing inventory must be brought in, either at cost price or at market price, whichever is the lower. Nothing is said as to how cost price or market price is to be ascertained, and in Canada at any rate the only pronouncement of the Courts on the question, that of Mr Justice Thorson in the *Anaconda* case, is not inimical to the accounting viewpoint.

B.C.'s Public Accounts

THE public accounts of the Province of British Columbia for the fiscal year ended March 31, 1953 have recently been released. There are two notable features reflected in this latest report on the finances of the Province of British Columbia which are worthy of special attention.

The most important aspect of these accounts is that for the first time they are prepared and submitted along the lines of recommendations made by Dominion-Provincial conferences on provincial financial statistics. Committees

of these conferences, under the auspices of the Dominion Bureau of Statistics, for many years have devoted a great deal of study to this aspect of provincial public finance and the Canadian Institute of Chartered Accountants has, through its committee on government accounts, collaborated closely in this work in recent years. The Canadian Bankers' Association, The Dominion Mortgage and Investments Association, and The Investment Dealers' Association are also keenly interested in the objectives of these conferences.

The second aspect is the fact that the accounts are available in two sections — (a) an abridged edition which contains the principal financial statements with accompanying detail, including those of all government boards, commissions, and enterprises, the finances and operations of which are not reflected in the general accounts of the Province; (b) the detail accounts which, in accordance with custom and practice, show particulars of both revenues and expenditures in complete detail.

It is extremely gratifying to note that British Columbia has now taken positive action towards implementing the recommendations of the conferences. The Minister of Finance for British Columbia is to be commended for this progressive step in the presentation of the public accounts of the Province. A similar presentation of the public accounts of all provincial governments would lead to a better understanding of the undertaking of these governments. Comparability between government accounts is also an important consideration.

Certain modifications and refinements in provincial public accounts have been introduced over the years. It is understood that other Provinces are now working towards these standard objectives. The Institute looks forward with interest to further developments in this regard.

The operations of the various governments constitute the largest and most complex business in Canada today and are of vital importance to every Canadian. It is very important that the accounts of all the Provinces be presented clearly, concisely, and on a uniform basis. It is also to be hoped that one of the objectives of the new system now inaugurated in British Columbia will be the earlier publication of the abridged set of public accounts.

PRIME MINISTER OF ONTARIO TO OPEN ONTARIO INSTITUTE'S NEW BUILDING

The new building of the Institute of Chartered Accountants of Ontario will be officially opened on Thursday, May 27, 1954, by the Hon. Leslie M. Frost, Prime Minister of Ontario. The building, which will also serve as the headquarters for the Canadian Institute of Chartered Accountants, was ready for occupancy at the end of April and both Institutes are now in their new offices.

The C.I.C.A. Annual Meeting

Progress With New Look

IT has already been announced that the annual meeting this year at Winnipeg will have a "new look", and members of the C.I.C.A. have received advance notice with an outline of the program. As sometimes happens with the "new looks" of fashion, the purpose of the designers may not be self-evident and perhaps a word of explanation might be useful.

There is no intention of dealing here with the provisions for hospitality and the sociable aspects of the annual meeting. As far as these go, there is no "new look" — simply the old, familiar, Winnipeg pattern which is, of course, celebrated and on which no one in his right mind would attempt to improve.

As far as the technical sessions go, a number of new objectives have been adopted. From a glance at the preliminary program it is obvious that there will be a lot more technical sessions than in the past. However, as well as having more sessions we also have new ideas about procedure.

In the first place we have gone on the principle that when technical subjects are discussed there should be different groups in session to provide a good choice of subject. Something should always be going on which might reasonably be expected to interest each member in attendance. An attempt has therefore been made to schedule a choice of subjects so that members-in-practice, members - in - industry, and members-in-government will each find some congenial topic. Two main themes run through all technical sessions — (a) the problems involved in conducting an auditing practice and (b) the accounting problems of management. It is expected that some

PROMINENT ACCOUNTANTS TO ADDRESS CONFERENCE

Mr Walter J. Macdonald, F.C.A., president of the C.I.C.A., has notified us that Mr. George Currie, C.M.G., D.S.O., M.C., C.A., of Montreal, and Mr William F. Holding, F.C.A., of Toronto, will be the speakers at the opening technical sessions of this year's conference at Winnipeg, commencing on August 23.

Mr Currie, a senior partner of McDonald, Currie & Co., will speak on "Conducting an Auditing Practice Today and Tomorrow".

Mr Holding, president of General Steel Wares Ltd. and also a past president of the Canadian Manufacturers Association, will speak on "Financial Management in Industry — the Requirements of the Job".

practising members will choose to attend the sessions on management problems and that some non-practising members may be attracted to sessions which are slanted at practising members. In other words, there will be no attempt to divide those attending the conference into two groups — the practising and the non-practising.

In the second place, we are attempting a carefully planned sequence of meetings. On the opening day we start with what our American friends would describe as "key-note addresses", one on the conduct of an auditing practice and the other on management problems. The next day there will be panel discussions in which the two main themes are developed. On the third day the subjects will be explored further in group discussions. The groups will be limited in size and we expect a completely informal, unrehearsed discussion of the material presented in the earlier meetings.

Apart from the plans for Winnipeg, the C.I.C.A. has a committee working on long-term proposals for the design and conduct of annual meetings. It is felt that a thorough review should be made of the scope, duration, location, and timing of the annual meeting. There are many fundamental questions to study, such as the proper balance between social events and technical sessions. It goes without saying that the work of the Annual Meetings Committee would be greatly helped if lots of suggestions were made by members. There are, of course, many different ideas about what should be emphasized in the annual meeting program. The more suggestions the committee receives the more likely it is to emerge with something reasonably sensible in the way of recommendations.

Under present-day conditions, conventions have to be planned long in advance and it is only gradually that new ideas can be worked into effect. What we hope to get eventually is the type of annual meeting which no self-respecting member can afford to miss if he wishes to keep up-to-date.

NOTICE OF CHANGE OF ADDRESS

Please note that effective May 1, the address of the Canadian Institute of Chartered Accountants and of the Institute of Chartered Accountants of Ontario is:

Chartered Accountants Building,
69 Bloor Street East,
Toronto 5, Ontario.

This is also the new address of *The Canadian Chartered Accountant.*

Professional Accountancy

By Kenneth F. Byrd, M.A., B.Sc. (Econ.),A.C.A.
Professor of Accounting, McGill University

The accounting profession has come a long way since the origination of double-entry bookkeeping in medieval Italy

THE accountancy profession has no long history upon which to draw for evidence of its dignified status. Let it be admitted at the outset that it is, in the roll of great professions, a comparatively young member. This admission need take away nothing from its essential worth and its assured position in the modern world. While the chartered accountant has no such trail of glory across the world's history as can undoubtedly be traced by the true physician, there can be no doubt that he is the physician of modern business. He prescribes for it in its sicknesses, undertakes surgical operations, if necessary, and brings it back to health, for the greater good of itself and the community of which it forms a part.

Origins

I do not propose to say much here about the early origins of our profession. There are brief references to the practice of accountancy in Venice, somewhere around the year 1580. Double entry book-keeping is now believed to have originated in Italy in the thirteenth and fourteenth centuries, while the first text-book on the subject dates from the end of the fifteenth century. Luca Pacioli or Paciolo, the author, was a university professor of mathematics. Though professional accountants are not mathematicians (credited as they may be by the layman with feats of mathematical genius which are quite imaginary!), there is a connection with mathematics to which they can lay claim. The student should note that he can learn a great deal, though not specifically useful for examination purposes, by studying the history of double entry book-keeping about which he can read in an excellent book by Peragallo.[1]

Some of our basic accounting concepts in determination of profit and loss arise from the features of early venture trading, when commercial transactions were divided into separate ventures consisting of independent voyages, each regarded as terminal and separately costed to determine profit or loss. Such conditions were very different from the vast, complex, continuing businesses of today, which are a product of the modern busi-

[1] "Origin and Evolution of Double Entry Book-keeping," by E. Peragallo, American Institute Publishing Co.

An address to the 5th Maritime C.A. Students Conference, Moncton, June 1953

ness world. These have arisen since the formation of the joint stock company in the latter half of the last century. As things have developed today there can be little similarity between the old mercantile venture and the modern vast limited company, with owners (as stockholders) scattered all over the world, and with ownership completely divorced from management. It is hardly likely, it would seem, that accounting concepts which were formed under the influence of the old conditions, in the 70's and 80's of the last century, can be equally suited to the so greatly differing conditions of today.

Birth of the Accountancy Profession

The oldest existing professional accounting bodies in Britain and in Canada date from almost the same time. The Institute of Chartered Accountants in England and Wales was incorporated by Royal Charter on May 11, 1880, and the Institute of Chartered Accountants of Quebec on July 24, 1880. This year may perhaps be regarded as the year of birth of the accountancy profession in the English-speaking world.

Not all persons welcomed the arrival of the new aspirants to professional status, and members of the legal profession voiced their disfavour. G. F. Sanders, in an address to the Sixth International Congress on Accounting in London last year, quoted Mr. Justice Quain as saying in 1875: "The whole affairs in bankruptcy have been handed over to an ignorant set of men called accountants, which was one of the greatest abuses ever introduced into law."

FEATURES OF PROFESSIONAL STATUS

Expressed Objects in Charters

From the first the newly born Institutes were concerned with the acquisitions and maintenance of professional status. The charter of the Quebec Institute says: "The objects of the Institute are to maintain the status and promote the efficiency and usefulness and regulate the discipline and professional conduct of its members . . ." The New Brunswick Institute, incorporated in 1916, takes as its objects: "(a) To establish a high standard of qualification and fitness for the profession of accountancy . . . .; (b) to provide for a better definition and protection of the profession; and to ensure a supply of educated men of special scholarly and moral qualifications, and responsibility . . .; (c) To promote and foster in commercial circles a higher sense of the importance of systematic and correct accounting and modern business methods . . . ; to endeavour to bring about a greater degree of efficiency in those engaged in book-keeping; (d) to encourage improved methods in book-keeping."

Professional Ethics

The New Brunswick Institute, like all the other professional Institutes, has its own rules of professional conduct. Essential among these is the rule against any form of advertising by a chartered accountant, because it "would lower the ordinary standard of dignity expected from a member of the profession, or be of such nature as would tend, in the opinion of Council, to bring the profession into disrepute". Another rule provides: "No member may certify or append his signature to or permit the use of his name with any statement, exhibit, schedule, or other form of accountancy report, whether for publication or not, which is prepared in a manner which might tend to confuse or in any way to disguise the actual situation."

These rules are typical and are clearly basically sound and necessary for the maintenance of professional dignity. The designation "Chartered Accountant" is its own advertisement and the addition of any other designation can only detract from it. I see that the New Brunswick Institute expressly forbids the addition of "Investigator", "Tax Consultant", "Systematiser", "Cost Consultant", "Production Engineer" or any other capacity "which is not foreign to the functions of a chartered accountant". It seems indeed fit and proper that the title "Chartered Accountant" should stand alone, with the self-evident value and dignity which long years of experience have given it.

It can hardly be too greatly stressed that while to individuals the rules against advertising of professional practices may seem at times unduly restrictive, they are absolutely essential to the maintenance of professional status. Competition between members of the same profession must result from the unadvertised reputation of such members, based on general and personal knowledge of their characters and abilities, evidenced in their daily actions, and on the conduct of their practice which must speak for itself. To permit even the suggestion of self-advertisement would be to open the doors to all those unprofessional and cut-throat practices which may be thought of as comprising much of commercial life.

A new-comer from Britain must immediately notice one respect in which professional accounting practice in this country and the United States is less restrictive than in Britain. While rules against advertising or solicitation of business are the same it is, as you know, common practice in North America to publish, in a public advertising medium, a firm's professional card, containing simply the firm name, the names of chartered accountants associated with the firm, and the business, telegraph and telephone addresses. Even this very limited form of advertisement is prohibited in Britain, where professional cards are non-existent.

Maintenance of Prestige Among the Professions

Now that accountants have won an accepted place among the professions, they are anxious to avoid any possibility of losing such a position. Thus I remember that, some time ago, the American Institute of Accountants, after circularizing practitioners and partnerships in its membership, to ensure that the majority were in favour of its action, made representations which secured the specific exclusion of certified public accountants from the self-employed workers given old age benefits in an amendment to the Social Security Act. They were the only well-known profession previously omitted from such specific exclusion. Such crises have frequently led to discussions, particularly in the United States press, as to the essential characteristics of a profession.

The National Labour Relations Act in the United States defined a professional employee as one having "knowledge of an advanced type in a field of science or learning, customarily acquired by a long course of specialized intellectual instruction and study in an institution of higher learning". *Fortune* said that a trade is a profession only if, in addition to all else, it is powered by a sense of mission. Perhaps I might conclude this stage of my address by quoting a comprehensive definition by a distinguished legal authority, Lord Simon:

> First of all, a profession essentially involves this, that it is based on preliminary study and, it may be, examination on the general principles of the pursuit. In the second place, a profession, I venture to think, essentially involves this, that the profits which may be made from its pur-

suit do not primarily depend upon the command of great quantities of capital. Thirdly, and most important of all, a profession is a pursuit which is followed not solely as a livelihood, but always subject to over-riding duties, prescribed by a code of professional honour involving in an especial degree the strict observance of confidences, in which the work that we do must be rendered to our clients without stint, in proportion to our clients' need rather than in proportion to the reward we receive.

Here are cited the three essentials: (1) education in the principles; (2) capital represented by personal abilities and reputation rather than money; (3) service to the community above personal reward. They may be taken as summing up the whole theme of my address.

Let us make quite certain that none of the fears expressed by Thomas W. Byrnes of Columbia University shall ever be realized in Canada. In the April, 1953, copy of *The Accounting Review* he says there are in the United States two schools of thought on the question of professional relations of the accountant with his client. He charges one school with regarding the chief duty of partners in professional accounting firms as to "circulate, make social contacts, publicize their firm . . . In other words they are salesmen". The *smaller* adopts, he says, "the professional attitude of giving personal attention to the client's problems". This is a damaging accusation and I have no doubt that it will have its reply. Certainly nothing but harm can come to the accounting profession if it is justly accused of the characteristics of Big Business, as Professor Byrnes calls it. There is a strangely modern note in the words of Francis Bacon, coming to us from three hundred years ago: "I knew a nobleman in England that had the greatest audits of any man in my time. . . . The gains of ordinary trades and vocations are honest, and furthered by two things chiefly: by diligence, and by a good name for good and fair dealing". But Bacon knew nothing of professional accounting audits and the gains he was thinking of *were* the gains of ordinary trade. Let us always be satisfied with the rewards which follow from personal skilled service in a noble profession.

EDUCATION FOR THE ACCOUNTANCY PROFESSION

There can be no real claim to professional status without (1) a sound cultural education to prepare the mind for association in the general affairs of life and for all the responsibilities which make up a civilized existence in a modern community, and (2) the technical education appropriate for training in the specific duties of the profession.

Full Time Education and Training in Theory

I would emphasize that I am here thinking, in both cases, of what can be studied and learned off the job, even before any position is taken up within the profession. I am convinced that it is quite vital to distinguish between a training in theory and a training in practice. It delights me to find, occasionally, professional men of long experience who agree with this statement. Thus Alan Grant Mann, C.P.A., says in the December, 1950, *Journal of Accountancy*, that the trained theorist, not the man with mere practical experience, will in the long run prove the best staff man. He advises a regularly organized course of studies, such as classes once a week for an hour before starting work, with informal discussion and argument. I would myself go a great deal further than this.

University Training

As a university man I am certain that training within the university for the accountancy profession is the most desirable preparation for professional life. I do not say it is most desirable for all persons and I would certainly not have it made exclusive, unless all the prohibitive questions of cost were removed. But if university training is being correctly given, then I am convinced that the student so trained will have more to contribute to the accountancy profession, in the long run, than the student who plunges into the technical duties straight from school and learns only the technical side, and that while on the job.

It must be remembered that the fears as to university training are two-sided. The university men in the Arts and Science faculties fear that introduction of accountancy as a university subject will bring purely technical material into courses which should be concerned with basic theories and principles. They themselves fail to realize that a professional qualification must be founded on principles which should themselves constitute material for intensive and extensive study, far removed from the mere techniques which result from application of those principles in actual practice. The professional man, on the other hand, fears the university course because he thinks it will result in turning out airy theorists who have not, and never will have, any grasp of practicalities, when it comes to working in the profession. This is very broadly stated and generalized, but I know that it represents the attitude of many.

The Quality of Accounting Instruction

Unfortunately, much of the teaching in accounting, even in the universities, lends itself to the accusations of the university men from other faculties. We are fighting constantly to lift the teaching of accounting, from the very earliest stages, out of the category of accounting drill and into that of accounting theory and practice. From the beginning the subject can and must be taught as something far from mechanical and not merely following from traditional rules to be memorized and applied implicitly, without thought or justification. The spirit of adventure can easily be introduced by a teacher with enthusiasm and imagination. Questions to be answered must be varied throughout the course, conveying some idea of the infinite variety of accounting situations.

The student must never expect to learn by mere repetition. He should come to appreciate a wide variety of problems introducing many and varied applications of basic principles. If he learns this from the beginning he will come to rely on his own ability to apply in practice the principles which he has thought out and learned. He finds this difficult, especially when limited by the time factor in examinations, but it is a necessity of sound professional training that such difficulties shall be overcome, and in overcoming them the student matures into the educated professional accountant. The professional examination papers themselves introduce a wide variety of questions, not repeating them from examination to examination, and this quite properly means that sound preparation for them must be evidenced by an equally wide variety.

General Trend Towards University Training

I shall shortly study in some detail some of the major problems in which research, in my opinion, may best be done within the universities. But I would first draw attention to the fact that throughout the English-speaking world the trend seems to be very definitely in the direction of handing over to the uni-

versities the training of professional accountant students.

(1) *In the United States*

The American Institute of Accountants recognized in 1937 the desirability of a four-year college course in the liberal arts, followed by graduate work in accounting. The University of Texas instituted some years ago a post-graduate course leading to the degree of Master in Professional Accounting. Since the famous Harvard Report liberal and professional studies have gone on side by side. The curriculum of Champlain College, State University of New York, provides for purely liberal subjects in the first year, without specialization, Accounting Theory and Practice and the Elements of Business being introduced only in the second year, along with the Arts, including a modern language.[2] The third and fourth years give scope for the students' individual choices, according to the careers for which they are preparing.

In April, 1952, *The Journal of Accountancy* reported that between 60% and 70% of candidates at the C.P.A. examinations are college graduates. In June, 1952, the same journal, referring to the organization of a commission to investigate the unification of educational and experience requirements for the C.P.A. certificate, throughout the United States, cited as one of the problems to be settled the question of whether a college education should be made a prerequisite for the C.P.A. certificate, and whether a four years bachelor's degree should not be followed by advanced study in a professional school. Again in the September issue the most recent analyses made by the Education Department of the American Institute are said to show the margin of superiority of college graduates, with public accounting experience, to be widening as compared with earlier records. Yet it is commented that substantial numbers of candidates still lack both public accounting experience and college education.

In the *Harvard Business Review* of October, 1952, Professor James W. Culliton speaks of the revolt against over-specialization which has characterized practical education in the United States, and he urges business to indicate its need for broadly trained men. A practice to be noted is what is called interneship training. This means that during the period of his studies at a university, the student has a period of several months' full time training in an accountant's office or sometimes, alternatively, in an industrial position. The American Institute's committee on education has expressed its opinion that the interneship plan is the most important means of improving the effectiveness of academic training of accountant students.[3] We may yet have to experiment with this development in Canada.

(2) *In Britain*

Accounting students still study in Britain mainly by means of highly efficient and competitive independent and privately conducted correspondence courses. Nevertheless a scheme was inaugurated five or six years ago, in conjunction with the main universities, by which students may elect to study, within a minimum period of 5 3/4 years, for both a university degree and a professional accounting qualification. The articled students thus spend 2 3/4 years in a university, on a full-time basis, and three years in the office of a practising professional accountant. The Members' Handbook of the Institute of Chartered Accountants in England and Wales contains the following comment:

The approved degree courses, while af-

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[2] See *The New York Certified Public Accountant*, September, 1951

[3] *The Journal of Accountancy*, October, 1950

fording the universities the medium for giving the student a liberal education and an intellectual discipline, are also intended to enable the student to understand the principles underlying his profession and to derive greater profit from his actual experience in his principal's office. The degree courses comprise accountancy, economics and law (these being taken throughout the whole period) with a modern foreign language (or another recognized degree subject) and the study of government.

The university degree exempts the student from the intermediate professional examination.

(3) *In South Africa*

The training of professional accountant students in South Africa has recently been handed over entirely to the universities. The intermediate professional examination has been discontinued and replaced by the examinations of the individual universities, so that the sole examination set by the professional bodies is the uniform final examination, for which training will still be given at the universities. Control is effected by a Public Accountants' and Auditors' Board, on which there are two representatives of the universities.

(4) *In Quebec*

In the Province of Quebec there is already very close association between the universities and the Institute of Chartered Accountants of Quebec. It is our main concern to see that our university instruction is as broadly based and as imaginatively conceived as it can be, from the first year of the student's introduction to the subject of accounting to the final year of his qualification as a professional accountant. In Quebec there are two paths by which the accountant student may qualify, not unlike those now found in Britain. One path is the usual one of evening study, while the student serves his five years in a practising accountant's office. The other is by way of a B.Com. degree at the universities, with a major in Accounting; this is followed by two years of evening study and examinations leading to the university Diploma of Licentiate in Accountancy with a minimum of one year's practical experience in the office of a practising public accountant. By this means he omits the intermediate professional examination and obtains, by his Licentiate Diploma, the right of membership in the Quebec Institute of Chartered Accountants. In practice McGill University elects for its students the actual final chartered accountants' examination, but it is not required to do so.

Stimulating the Student's Imagination

Our university training should be directed to stimulating the thought and imagination of the professional student, whether his study be full-time or merely part-time evening study. In every way the former is bound to be better. Though we perpetually complain that too little advantage is taken of it, the full-time student has the opportunity for intensive and extensive reading and study during the formative years. At this time he can follow up and satisfy himself as to the basic tenets of his prospective profession, not merely accepting and memorizing established traditions, but accounting for them and studying them from every angle. He can and must make a thorough study of economics, and this should help him very greatly in his later thought life and in his approach to countless professional problems of every day. He is conditioned unconsciously for a very different attitude, in his daily professional life, from that of the man who has qualified in the hard way, by part-time study crammed in with practical experience. I shall not elaborate on this, but if the universities are giving proper training to the professional student I am sure that the change in mental outlook is bound to have a profound effect on his profession-

al life. There are so many problems to be studied. Full-time study in the university gives the early opportunity and incentive, and habits formed in the early years will, I hope, be carried over into the whole professional life.

Initially, of course, the graduate straight from the university will show to disadvantage in practical experience, compared with the student who has had practical experience since his school days. But in the long run it seems certain that if the university training has been thorough and the student has not simply wasted his time, the habit of thinking things through and working from basic principles will prove its worth. Our profession can only advance as its members keep themselves up-to-date with changing times and are prepared to break with outworn conventions, if they fail to meet the test of modern needs. There will always be much for the thinking professional man to read and also to write. Those most likely to be ready and able to contribute to our professional journals and to stimulate our current thoughts are the men who were trained to do this in their early years. And never did our maturing profession need more thoughtful, critical, and constructive contributions from its members than it does today.

Training the Professional Accountant for Industry and Commerce

The Members' Handbook, 1950, of the Institute of Chartered Accountants in England and Wales, says: "The accountancy profession now embodies a much wider field than that of public accountants and it is of no little importance to the Institute that the qualities of its members and their training in public accountancy have so ably fitted them for onerous duties within industry and commerce." The profession is indeed divided today between members in practice, or employed by practitioners, and members holding positions in commerce and industry, and there is a school of thought which argues for special courses of training for the latter — and logic would seem then to demand separate examinations.

The Sixth International Congress on Accounting in London last year devoted separate sessions to "The Accountant in Industry" and "The Accountant in Practice and in the Public Service". F. R. M. de Paula, one of Britain's senior and best known chartered accountants, himself with many years' experience as an accountant in practice, an accountant in industry and a professor of accounting at London University, asked the following questions: (a) Does management accounting represent a new and specialized technique within the field of accounting? or (b) Is it a specialized technique outside the field of general accounting but embraced within the field of engineering?"[4] And if the answer to (b) is yes, he asks among other things: "Is there a need for public accountants in general practice, specialized in this new technique, to advise industry in the installation of systems of management accounting? Should there be facilities for providing specialized training for such specialists? If so, how should such training be provided?" Mr. de Paula stated his belief that there was a need in industry for accountants skilled in management accounting, and few would today dispute this statement. In the discussion which followed Professor Greenwood of South Africa said he was worried about the tendency to try to turn both types of accountant out of the same mould, for he did not think it possible.[5] He disagreed about the desirability or practicability of integrating pro-

[4] Members' Handbook, 1950, Institute of Chartered Accountants in England and Wales, p. 13

[5] Sixth International Congress on Accounting, 1952, Gee & Co., London, p. 251

fessional and industrial accountants, for he thought they had little in common. Professor Greenwood said he was speaking here as an educationalist, but I fear myself that the practising accountant was in the ascendant.

Mistaken Emphasis on "What is Done in Practice"

It seems to me all to go back to the root question: Can "what is done in practice", whether it be in public practice as an accountant or as an accountant in industry, be taught at the same time and in the same place as the basic theories and principles upon which the whole of accounting, in its different branches, rests? The average accountant seems to me to test the student's studies by whether they are a reflection of "what is done in practice". So often a problem calculated to make a student think out important matters of principle is condemned as different from practical experience. Now I am strongly of the opinion that accounting is a fit and proper subject to be taught in the universities, and I have shown that it is being so taught increasingly throughout the English-speaking world. But if the teaching of accounting is to be confused with training in practical procedures then it must be condemned as not proper for university curricula, and certainly not for undergraduate curricula.

I can make a strong case for inclusion of a first course in accounting, properly taught, in an Arts curriculum, because it has so much to stimulate the thought and wake the imagination of the student. But when it comes to the teaching of techniques then I say we are dealing with something outside the scope of any educational authorities. The learning of specialized techniques, I am myself convinced, begins on the job, when all the sound knowledge of theory and principle acquired in a long course of educational preparation can be applied to working out the problems that present themselves in practice. And the practice may, to my mind, be either in public accounting or management accounting.

Professional and Industrial Accounting Both Post-Graduate Fields

I agree that these fields are very different, and they are diverging more and more in the world today, but they are both post-graduate spheres. The specialized training should be done outside the educational institutions in close association with practical work in the appropriate field. Mr. de Paula did not let Professor Greenwood go unanswered and expressed his conviction that both practising accountant and accountant in industry could come out of the same mould and that cross-fertilization was urgently needed. In the United States this whole question is much under discussion. In March, 1951, the editorial of *The Journal of Accountancy* quoted Professor Leo Schmidt of the University of Michigan as advocating an examination for those pursuing a career in industrial or commercial accounting, giving the successful candidate the right to a title — presumably appropriate letters. The editorial asked for the comments of readers on this "provocative" idea.

In *The Accounting Review* for July, 1950, Professor W. F. Vatter of the University of Chicago strongly supported the idea of special training in the university for the position of controller, as a member of the management team. He regretted that education is still based on the notion of accounting as essentially a profession, quite apart from the rest of business administration. He urged that the controller is "more than a kind of glorified accountant". He would have the first course in accounting, for the general business student, apply itself realistically to the problems of planning,

with illustrations "from the real world of cash registers, billing machines, punched cards, etc.", instead of pen-and-ink book-keeping. Similarly Victor Z. Brink of the Ford Motor Co. calls for curricula which combine the basic features of a business education with that of industrial engineering in its more technical sense, such curricula representing an extension of one or two years over the normal.

I have given some time to this matter because it undoubtedly indicates changing conditions in a changing world. I cannot too strongly disagree with Professor Vatter about "the real world of cash registers", in relation to the first or any year of the university accounting curriculum. There may well be some development in an extension of one or two years over the normal, as suggested by Mr. Brink, but I think this should be part-time study, while practical experience is being gained, or at any rate post-graduate work.

PROBLEMS FACING THE ACCOUNTANCY PROFESSION

Accounting Must be Dynamic

If accountancy is to flourish as a profession it cannot stand still. It is inconceivable that, in the 70 years or more since the oldest Institutes of Chartered Accountants were born and the basic principles of accounting were formulated, there can have been no change in such principles. Some accountants seem to be so bound by tradition that they cannot adapt themselves to the slightest departure from long-established procedure.

Breaks with Tradition

How many accountants to-day would discourage their clients from "rounding" figures, in the published accounts, to the nearest dollar? A great many would do so, I fear, and more would refrain from suggesting or encouraging such a practice, feeling that it is a departure from that strict rule of absolute accuracy and precision on which the professional accountant so prides himself. Yet a moment's thought will show how wrong such a conception of absolute accuracy must be, when contrasted with the unreliability of any balance sheet as a statement of the financial position at a given moment. The net worth revealed by the balance sheet cannot, except by pure accident, be a reflection of the current value of such net worth. Current and fixed assets are valued on such different bases, there is no adjustment for the changing value of the dollar in an age of inflation, secret reserves may be created and intangible assets omitted. Why then worry about a few cents one way or the other, when their omission will leave a more intelligible and less crowded picture? A far more radical break with tradition is the abolition of cents even from the books of account, except in the case of the cash and personal accounts. Not many do this, but it has long been done successfully by Bethlehem Steel Co., and lately one or two others, including Canadian Kodak Co.,[6] have followed suit. The professional accountant must be prepared for new developments and, if necessary, he should lead the way in making them.

There are many features in today's published accounts which were unknown a few years ago. In Canada the practice of giving comparative columns to reveal last year's position alongside this is still

[6] *The Canadian Chartered Accountant,* March 1953, R. L. B. Joynt, C.A.

not nearly general enough. Without them the published statements lose half their usefulness, and the 1948 Companies Act in Britain has made such comparative columns necessary.

The Canadian Institute Research Bulletins

This brings me to a matter of some importance in Canada. We all know, even if the general public unfortunately does not, that the professional accountant is not responsible for the form of the published financial statements on which he is required to report. He has no right to alter them in any way, for they are not his statements but those of his clients. Nevertheless it is obvious that the professional accountant must have a very real influence on his clients and, in numerous cases, it is hardly credible that he could not persuade them to make changes in the form of their published accounts to conform with the most up-to-date practice. Yet it is most significant that recommendations made by the bulletins of the Canadian Institute of Chartered Accountants, such as this for supplying comparative columns and that for deduction of depreciation provisions from the appropriate assets, are still so often ignored.

Do Canadian accountants give enough attention to these published bulletins and do they bring them to the notice of their clients in an attempt to have them implemented? It hardly seems likely that they do. I can think of a case in which a well known company deducted from its inventory an addition of $500,000 to its reserve for future decline in inventory values in calculating the year's profits, thus treating it as a charge instead of an appropriation. The profits were certainly understated by $500,000. Another company included under one caption, "reserves", and in one total on the balance sheet, its accumulated depreciation of over $36 million and a general reserve of $5½ million, yet only the latter is part of the stockholders' net worth. I should mention here, by the way, the distinction between reserves and allowances which has formed the subject of another recent bulletin. Are practising accountants pressing on their clients these considerations of selective terminology, intended to clarify the accounts? These things are not trivial matters but important features which the professional accountant should be striving to amend. Perhaps I am over-estimating the attention paid by Canadian companies to the representations of their independent accountants. At any rate I recommend these matters to the attention of the students who will be the professional accountants of tomorrow.

Accounting for Inflation

Now I come to a much more hotly debated problem. If accountants give little heed to the things I have mentioned they are not likely, I fear, to give much attention to the question of adjusting the accounts to counter the effects of inflation. It cannot be disputed that the declining value of the dollar, in this age of inflation, has played havoc with published accounts, regarded as reflections of the profits and financial position of large corporations.

One or two illustrations may here be useful, taken from recent practical cases. Professor Albert L. Bell of Franklin and Marshall College gives, in *The Accounting Review* for January, 1953, the following results of conversion of the machinery and buildings records of the Armstrong Cork Co. by use of two specific price indices with 1913 as base. In 1948, 1949, and 1950 conversion increases the charge for depreciation by 95%, 81%, and 83%, respectively, representing from $2 million to $2½ million each year. This is more than 20% of the annual net profit of $10 million

In *The Journal of Accountancy* for November, 1952, Mr. Paul Grady, C.P.A. gives the ratio of net income to equity capital for all United States manufacturing corporations, before and after price level adjustments to inventory, fixed capital and depreciation, annually from 1926 to 1951. Only in 1926, 1931, and 1932 is the return shown to be greater, or the loss smaller, after adjustment than it was before. In 1951 conversion reduces the rate of return from over 12% to just under 7%.

Finally, in the National Association of Cost Accountants' Bulletin for October, 1952, Fladger F. Tannery, cites a case where a company started in 1922 with plant and equipment at $1 million. There have been few changes in the manufacturing process down to the present, the same equipment having been used throughout, with only ordinary repairs. Engineers now estimate, says Mr. Tannery, that within a year the equipment will have finished its useful life, the cost of vital major repairs being much more than that of new equipment. The cost to replace the original $1 million equipment will be well over $2 million. Here is the perfect illustration of the vital necessity for retention in the business of so-called profits to provide for the extra $1 million of capital required to maintain production, after years of inflation. Maintenance of production is something very different from expansion, for which the raising of fresh capital is, of course, quite justifiable.

The Need for Action by the Accountancy Profession

As a professor of accounting I am firmly convinced that sooner rather than later we must change our accounting principles and practice to meet the needs of an age very different from that in which such principles were formulated. I am greatly encouraged by Paul Grady's article referred to above. He is a practising accountant, a partner in a great firm, and he strongly urges that the accountancy profession should assist in developing methods of disclosing profits caused by falling dollar values. He would have the profession comment on the fairness of the presentations so made. He suggests that the time has come for the committee on accounting procedure of the American Institute of Accountants to publish a new research bulletin, superseding its former recommendations against change. He would have no departure from historical costs as the normal basis of accounting, but would have the Institute recommend disclosure of inventory profits caused by price level changes and of the annual depreciation provision adjusted to current dollar costs. In the case of inventories, he says, the opening inventories valued on a FIFO or average cost basis, would be converted to closing prices, and gains on LIFO inventory liquidations during the year would be separated. He would have the depreciation adjustment made by use of the consumers' price level index of the Bureau of Labour Statistics. Disclosure might be made (1) by footnotes to the financial statements, (2) by adjustments in the income statements, whether supplementary or regular, (3) in supplementary financial statements with all items in current dollars, the net income and surplus being reconciled with the historical financial statements.

I mention this problem in some detail because I believe it to be *the* fundamental problem facing the professional accountant to-day, and I know that it is general, though certainly not the unanimous, opinion that nothing can be done about it. Yet of the seriousness of the problem there can be no question.

United States Steel Corporation tried to deal with it in 1947, by making an extra charge of $26,300,000 against

profits, over and above provision for normal wear and tear of $88 million, calculated on historical cost. They were prevented by the Securities and Exchange Commission and the American Institute of Accountants, and made to reverse the charge in 1948, being allowed (but not for income tax purposes) the alternative of accelerated depreciation, which they adopted.

In Britain in 1951 Imperial Chemical Industries Ltd. took action which could *not* be prevented. They wrote up their assets by £96 million sterling, crediting capital reserves, and proceeded to charge the profits with depreciation on the increased figure. The annual charge to profit and loss account was thus increased from £6 million to over £8 million. In addition the company is now appropriating £5 million per annum from accumulated profits, to build up a reserve in respect of past underprovision for depreciation, resulting from inflation.

Another company in Britain, Yorkshire Copper Works Ltd., made its second quinquennial valuation of fixed assets at July 31, 1952, writing them up by £880,966 sterling to £2,462,821 and charging depreciation on the revalued figures. They have expressed the intention of revaluing in this way every five years and adjusting values upwards or downwards. The required increase in the 1952 depreciation charge is £70,000, which means, says the chairman, that to maintain its profits in the conditions of inflation the company needs to earn an additional £280,000 — £70,000 for depreciation and £210,000 for income tax, profits tax and excess profits levy on the illusory profit represented by the £70,000.

A Point to Remember

It must be emphasized that it is the charge against current profits for depreciation on the increase in value of the assets, resulting from falling dollar values, to which the traditional accountant takes such strong exception. I think this charge is proper for I do not agree that there is anything binding in accounting tradition by which depreciation provision must be calculated only on historical cost. It seems to me quite useless and dangerously misleading to report as profit the excess of income, calculated in current dollars, over current expenditures in current dollars and depreciation provision only in dollars of a by-gone day, perhaps 10, 20, or 50 years ago. The result is bound to mean that part of the so-called profits is in reality capital which should be retained in the business to maintain, in inflated dollars, the productive capacity of the capital originally invested. It simply cannot be right to borrow from the public, whether by bonds or new stock issues, simply to maintain production and not expand it. I think of it from the point of view of the whole national economy, not of individual shareholders. Consequently it cannot be answered, as so often happens, that it is unfair to the preferred stockholder or bondholder that production should be maintained in this way for the benefit of the common stockholder. The productive capacity of the whole aggregate of productive concerns making up the resources of the nation has to be maintained. In times of deflation the reverse adjustments must be made, there is no doubt of that, but in the long run inflationary conditions will certainly be the main factor.

It will be remembered that the committee which conducted that investigation of business income which was financed jointly by the American Institute of Accountants and the Rockefeller Foundation reported on these lines: ". . . corporations whose ownership is widely distributed should be encouraged to furnish information that will facilitate the de-

termination of income measured in units of approximately equal purchasing power, and to provide such information wherever it is practicable to do so *as part of the material upon which the independent accountant expresses his opinion*".

In Britain the Association of Certified and Corporate Accountants has recently published a study of actual accounting techniques for dealing with the problem, under the title "Accounting for Inflation".[7] The view is taken that the "cost of exhaustion of a fixed asset as a result of current utilization" is the depletion in its *current* capital value which results from its use . . . Business income determined on the basis of this principle constitutes true current operating profit." This being so, an actual technique is worked out and fully illustrated for converting the traditional balance sheet and profit and loss account. The importance of this publication is that it comes from a body of professional accountants. The chartered accountants in Britain are as yet unconvinced, the incorporated accountants are much more in favour of change, the certified and corporate accountants have nailed their colours to the mast. In America the American Institute is still against action, though individual members like George O. May, Percival Brundage, and W. A. Paton, and the American Accounting Association of university professors are outspoken in their advocacy of supplementary accounts converted to common dollars. In Canada there has been no official pronouncement on the subject.

The Problem for C.A. Students

I warn students not to be dogmatic in dealing with this subject. If they advocate change, as I hope they will, let them not fail to appreciate and state that the problem has great difficulties and that many reputable and thinking accountants are still for maintaining the *status quo*. In examination answers, above all, they should indicate that they have read both sides of the question. I must admit that published suggested answers to general questions on the subject, which have appeared in past examination papers of the Canadian Institute, have worried me by their assumption that the professional accounting bodies are solidly for maintaining no break with tradition. But I suggest that, at any rate, it is safe to emphasize that supplementary converted accounts under the professional accountant's signature can be issued without any essential break with tradition, the traditional accounts being presented as before. This *must* be done for managements, in my opinion.

Accounting for Pensions

Among other problems of today one that will increasingly need the attention of the professional accountant is that of accounting for pension commitments, such as those which have been forced upon the great motor companies and others. If present-day wage agreements provide for these schemes, which will result in the paying out of vast sums of money to employees on their retirement, then clearly the present costs of such commitments are just as much part of the wages cost of current production as is the present pay-roll. Many companies are funding these commitments outside the business, at least in part, while others invest in the business the amounts charged as provisions for pensions. Others provide for the liability only as the employees' rights vest on retirement, a practice which is most unsatisfactory. A complication is the accounting for past service pension costs. The American Institute has recommended that these should be provided for as a charge against cur-

[7] "Accounting for Inflation," Gee & Co., London

rent and future profits and not as an appropriation from earned surplus, because current and future production will benefit. The problem of investment of the vast sums involved is a difficult one, as will be seen when it is realized that, for example, the Bell Telephone Co.'s pensions reserve is over $1,100,000,000 and is increasing by more than $100,000,000 a year.[8] Sears, Roebuck & Co. are investing their funds very largely in common stocks of the company itself, and the wisdom of investing in carefully selected common stocks of other companies, as a hedge against inflation, is obvious.

Buy - Build - Lend - Lease Financing

The growing practice of leasing large capital assets to finance their cost is an important development in financial policy as a result of the shortage of equity capital. The tenant assumes all the responsibilities and risks of full ownership, over a long term of years, with actual ownership in the end, and the question of accounting treatment is important. The independent accountant will certainly see that the commitment is clearly indicated in the accounts and that the profits bear their full share of depreciation, as if his client's ownership of the assets were already final.

Accounting for Income Tax Purposes and Otherwise

Not only in Canada is the gap between accounting for income tax purposes and generally accepted accounting principles a matter of concern to the accountancy profession. In the United States and Britain the problem is equally great, perhaps greatest of all in the former. *The Journal of Accountancy* of March, 1953 quotes the Chairman of the House Ways and Means Committee of the United States Congress as deprecating the necessity for many businesses to keep separate books for tax purposes and for stockholders. He is said to have invited the American Institute's Committee on Federal Taxation to help in revision of the tax structure, to eliminate the "debris of conflicting, unsound, and inequitable laws, decisions and rulings which make our tax system the monstrosity it is today". A hopeful sign is that Mr. T. Coleman Andrews, C.P.A., a past president of the American Institute, has been appointed the new Commissioner of Internal Revenue.

We all know the accounting differences between the income tax regulations as to depreciation in Canada and accepted practice — so serious that in Quebec, in many cases, three sets of accounts have to be kept, one for the Dominion Government, one for the Quebec Government, and one for practical business purposes. Accountants seem now to be resigned to this situation. In regard to reserves for services not yet rendered, the Dominion Government has made concessions to joint representations of accountants and lawyers, an encouraging sign that change is possible if the profession is vocal enough. Here is indeed a field for the professional accountant's attention. Membership of the Canadian Tax Foundation gives the opportunity for accountants and lawyers to combine in this direction.

The Dominion Companies Act Amendment

The Dominion Companies Act of 1934 is ripe for amendment, and a committee of the Canadian Institute of Chartered Accountants has already drafted recommendations. These recommendations have been submitted to the provincial Institutes and members have been asked for their comments. This is a matter of far-reaching importance and it is to be hoped that all chartered accountants

[8] *The Journal of Accountancy*, October, 1950, Prof. Paul Kircher.

are carefully considering it. I have myself been surprised to see that no suggestion has been made by the Canadian committee as to the necessity for publication by a holding company of its own financial accounts, in addition to the consolidated statements which it is at present allowed to publish alone. As is well known consolidated statements can sometimes be misleading and, in my opinion, the holding company's own position needs separate treatment. It interested me also to see that the committee was not unanimous in its wish to have abolished the present right, under section 12, to credit to distributable surplus a portion of the funds raised by an issue of no-par-value shares. I can think of little that is less justifiable than this provision, as a general right of all companies, for it goes against essential principles of sound accounting. I have recently been interested in the question of no-par stock, because of enquiries from overseas, where a commission is once more investigating the desirability of making such issues legal in Britain. The whole subject of the advantages and dangers of such stock is well worth careful consideration, but I rather doubt whether we give much thought to it over here. At any rate, if the distributable surplus has been regarded as a natural adjunct of the no-par share here is at least one feature not to be adopted by Britain.

A Summing Up of Professional Accountancy

In this address I have made no attempt to give a comprehensive definition of accountancy. Perhaps the definition has built itself up as we have proceeded and I can now draw the threads together. You will remember that I quoted among the New Brunswick objects "to endeavour to bring about a greater degree of efficiency in those engaged in book-keeping" and "to encourage improved methods in book-keeping". It is necessary, I think, to be very clear in what way this "book-keeping" differs from "accountancy". The difference resides in all the various features I have discussed — imaginative study and training; wide reading in accountancy and allied subjects, so that breadth of vision becomes natural to the student; the habit of thinking things through and not accepting them at their face values, which means an analysis of principles and a readiness to discard or adapt what no longer seems to stand the test of a new age; the ability to account for and justify apparently fundamental rules such as that of "the lower of cost or market" for inventory valuation; soundness of judgment to distinguish between capital and revenue transactions and explain the distinction, to decide the problems of divisible profits and dividends by reference to theory and case law, to advise on the countless problems that arise in dealing with the affairs of clients. All these are the breath of life to the practising accountant and they are all things which transform the prosaic and repetitive monotony of book-keeping, at someone else's dictation, into the inspired freedom and creative production of accountancy. The accountant in industry, the controller who heads the finance department, acting as the financial prophet of management, has to be equally alert, far-sighted, and imaginative. For the true accountant, whether in practice or in industry, should never have a dull moment. The business affairs of today carry enough challenges to keep him alert and eager to be doing. At no time can the professional accountant think he has learned his skill and earned the right to put aside his books. Today's accounting periodicals are brimming over with new ideas to be tested, with new theories to be considered, and the accountant who is prepared to read cannot possibly become stale.

The Importance of Case Law

One last word to the student. Never despise past case law. I myself think that case law is too little regarded in this country, in examinations and in class rooms — probably in the latter because of the former! A study of famous cases can be fascinating and most rewarding. Cases properly learned in one's youth are never forgotten. They can be drawn on for illustration in examinations putting in some evidence of the study of which examiners are so sceptical, and they can save so much involved and tedious explanation. You can get humour out of cases, as in the case of *Bond* v. *Barrow Haematite Co.* where the mine was a "floating" asset in two senses of the word, (1) because it represented inventory of raw materials, though yet unmined, and (2) because it was flooded out. You can get excitement, incredulity, admiration — all the emotions which enliven dull reading and make it memorable. For incredulity and excitement read "The Greatest Accountant in the World", in "Studies in Accounting", edited by Professor W. T. Baxter of London University. I seriously advise all accounting students to memorize the essentials of, say, five prominent cases in each of their five years of training, and they will have twenty-five cases to quote from for life. It is amazing what a reputation for learning such an ability is calculated to give!

A Recent Book

Employee Remuneration and Incentives, published by the Institute of Cost and Works Accountants; distributed by Gee & Co., London; pp. 70; price 7/6

This study by the Research and Technical Committee of the Institute of Cost and Works Accountants of Great Britain is a successful attempt to outline the factors influencing wage remuneration. It compares the various plans available which provide incentives in the wage structure and also puts into a working perspective the considerations affecting the design of the wage structure. It should be useful to unions as well as to management.

A brief but interesting introduction deals with the history of wages as far back as the labour shortage caused by the Black Death of 1349. After stating quite succinctly the underlying principles of remuneration, the committee has considered the methods used to provide incentives, including profit-sharing as well as those of a non-monetary nature. Later chapters discuss the characteristics of the various systems of payments in use and the effect of economic, social, and political factors on wages as a whole.

A chapter on present trends makes some good observations on a national wages policy and the current demand for increased productivity. It points up the problem of how to measure productivity and states that considerable research is now being done on this complex question.

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Hamilton, Ontario

Management Accounting In the United States

By Lloyd O. Morley, C.A., A.S.A.A.

A summary report by a specialist British management accounting team to the Anglo-American Council on Productivity

THE Anglo-American Council on Productivity was formed in the autumn of 1948 on the initiative of the late Sir Stafford Cripps, at that time Chancellor of the Exchequer in Britain, and Mr. Paul Hoffman, then Economic Co-operation Administrator in the United States. It is composed of representatives of management and labour in both countries. The purpose of the Council is to promote economic well-being by a free exchange of knowledge in the realm of industrial organization, method, and technique and thereby to assist British industry to raise the level of its productivity. The principal means adopted to achieve this end is to send to the United States industrial teams to study American production methods, to report their observations and findings, and to make recommendations. A considerable number of reports have been prepared and published.

The report on "Management Accounting" was produced for the Council by a British specialist team of 12 members, most of whom were either accountants or executives in industry. The principal British bodies of accountants were consulted before the team was formed and gave their approval and financial support to the project. The team visited the United States in April, May, and June, 1950, and was given unusual opportunities to study American management accounting in practice. It received valuable help in effecting introductions to business firms and in many other ways from the National Association of Cost Accountants, the American Institute of Accountants, and the Controllers Institute of America, as well as from the New York office of the Anglo-American Council on Productivity which planned visits and appointed a project manager for the team.

In the course of its enquiry the team or, more usually, small groups of the team visited about 60 companies, most of which were large nationally-known corporations located in the north-eastern States or the Chicago area. It also visited four schools of business at universities in these areas. On completion of its visit the team produced a report 71 pages in length[1]

[1] Obtainable from the Anglo-American Council on Productivity, 21 Tothill Street, London S.W.1.. price two shillings.

which is addressed primarily to executives and accountants in industry but which is of interest to a wider group. In this article an attempt has been made to summarize those sections of the report which are of general interest to Canadian accountants. No attempt has been made to comment on the British team's report, and many of the sentences which follow have been reproduced verbatim from the report.

Terms of Reference

The terms of reference of the British team were:

"To find out what accounting, costing, and statistical information is provided for American management at different levels, by what methods it is obtained, and how it is used."

In its report the team defined management accounting as the presentation of accounting information in such a way as to assist management in the creation of policy and in the day-to-day operation of an undertaking.

General Survey

Here are the salient points on which the team commented under this heading:

It is clear that American industry makes little attempt to measure productivity, preferring to rely on unit costs. Americans are convinced that productivity must be increased if the cost of the product is to fall.

In the opinion of the team, after very careful consideration, the greatest single factor in American industrial supremacy is the effectiveness of its management at all levels. The effectiveness of American management and accounting rests not on technical superiority but on their thorough application of techniques which are as well known in Britain as they are in the United States. American management has, as the mainspring of all its actions, the well-founded belief that unit costs must be reduced each day and every day, year in and year out. They are aware that, if the unit costs in real terms are not continuously reduced, the standard of living will not rise and the raising of the standard of life is a religion to Americans.

As low cost is the main object of American industry, no premium is placed on craftsmanship for its own sake. Only so much accuracy and refinement of finish are put into the article as are necessary to meet the standard of the quality range for which it was originally designed.

The urge to reduce costs involves management in a restless search for cheaper and better methods of manufacture. Cost reduction means fewer people producing more goods, and those who are no longer required are thrown on the labour market. Labour so far has been prepared to accept such changes as a condition of national progress and of the raising of the standard of living.

The freedom of competition which exists in the United States undoubtedly is a most important reason for the drive for lower unit costs. (The team questioned whether price agreements and quotas were having an adverse effect on the British economy by restricting technological advance. They suggested that it would be a real service to British industry if an independent commission could inquire into the nature of these agreements, report on their effect on British industry, and express an opinion as to what would happen if restrictive practices were removed.)

A new generation of managers has risen, many of whom have had training in management at the business schools attached to universities, who have learned the value of figure statements and what can be reasonably inferred from them. At the same time many accountants have realized that service to management is their main objective.

Mr. Lloyd O. Morley, C.A., A.S.A.A. spent his earliest years in Saskatchewan but was educated in England when his family returned there just before the depression. In 1938 he was admitted to the Society of Incorporated Accountants and Auditors. After World War II he came to Canada again and is now a supervisor with Price Waterhouse & Company in Toronto. He is a member of the Ontario Institute.

Organization

Companies make a point of publishing their organization chart to all levels of management. The financial, accounting, and costing functions are strongly represented at top executive level in the U.S. The majority of companies have a treasurer and a controller, and some large companies also have a financial vice-president. The controller, as his name implies, is much more concerned with control through figures than with mere recording. He is constantly in touch with the problems that face management and is used by his colleagues to provide information at the very earliest stages of policy formation. This has had profound effects on the attitude of the controller to his procedures: he has developed the interpretive function of accounting and relegated the recording function to a subordinate position. All the organizations studied emphasized that the controller belonged among top management. Both management and accountants realize that the primary purpose of accounts and costs should be to guide management in planning the future. This realization springs from the desire of management to base its decisions on facts and reasoned forecasts.

Top Management Control

The presentation of information to the board and to top executive management is fundamentally different.

In most instances long tabulations of figures in great detail are presented to the board each month. These reports are usually ready about the middle of the following month and always include a balance sheet and profit and loss account, and often statements of position of stocks (inventories), disposition of funds or working capital, capital expenditures, forward commitments, sales, production, and other appropriate statistics. The board is primarily concerned with the financial results of the company and leaves operational policy to the officers.

There are great differences between one company and another in the control methods and consequently in the reports required by the top executives. Much depends on the character and methods of the president, the sort of officers whom he collects around him, and the methods and ability of the controller. Certain definite characteristics of top executive control are, however, distinguishable:—

(a) Great efforts are made to reduce the quantity of routine reports given to the officers and senior executives. The trend in the most advanced companies is to keep routine reports to an absolute minimum and rely upon special reports given by the controller or his staff on urgent problems.

(b) Forecasts are common and are usually worked out by a budget committee or by the controller in consultation with the various officers. Often a number of different forecasts are prepared at the same time to estimate the effect of alternative courses of action. When changing circumstances render forecasts and budgets out of date, they are without hesitation scrapped and new ones made out.

Reports on current results are compared with the forecast or some agreed standard

of performance rather than merely with the past.

(c) Centralization of control but decentralization of responsibility is the keynote of American management. Targets are set. Every subordinate is judged by the results he achieves and is given as free a hand as possible in his method of achieving these results.

(d) There is a clear difference between the kind of information the senior and junior management require. Senior management is concerned with planning the future and setting control targets; therefore it spends more of its time studying forecasts and budgets. The nearer a manager is to the shop floor or to the customer, the more he is interested in the comparison of current results with budgets as a guide to immediate action.

Most companies use some sort of budgetary control. The period covered by the forecasts varies considerably and may be as short as a month or as long as a year. Sometimes a rough forecast is made for a longer period, say a year, and the firm budget for control purposes fixed at shorter intervals, say every quarter. In a great number of companies budgets are made for an indefinite period with standard expense allowances varying automatically according to the volume of activity.

Once a target has been set which is measurable in figures, the officers expect their managers and foremen to reach that result. They give guidance on policy and any help or advice that is required, but do not give detailed instruction as to how to achieve the results. One of the consequences of this attitude is the necessity of determining exactly for which items of expense and for which results each manager or foreman is responsible. This has the very valuable effect of requiring a clear-cut organization with well defined limits of responsibility. A further consequence is the necessity of getting subordinates to agree to the standards by which they will be judged. Some companies get them in the first instance to establish those standards, which are then checked, whilst in others the standards are set in the controller's office and agreed by the person for whom the standard is set. The advantage of this development is that as the individual manager, whatever his level, knows his responsibilities and the limits of his power, he feels a freedom and a confidence that let him get on with the job. This is one of the main reasons for the vigour of American management.

Reports of results are usually expressed in terms of actual, standard, and variances over and under standard. Officers and managers usually get only those results which concern the part of the business for which they are directly responsible. Reports are often handed out personally by the controller or a senior member of the staff, with a verbal explanation of the figures. The controller's close working with the management has made him acutely conscious of the time factor in his submission of reports.

Design and Manufacture

Control of Project Costs, etc.

New products are discussed and decided upon at board level.

Every firm visited controls expenditures for all new projects, though the method of control varies between firms.

Quality does not suffer as a result of standardization or mass production. It is just as possible to produce large numbers of high-quality articles by the proper planning of tools, jigs, and fixtures, and by careful inspection, as to produce small quantities by the exercise of skill and craftsmanship. It is not considered efficient to design and plan for parts of higher quality or better finish than necessary.

When the adoption of new processes involves the purchase of new equipment, the purchase requests are invariably accompanied by a detailed analysis of the economies which should result. Reports comparing actual costs with budget are issued to all concerned, usually monthly, as the project is developed. In the opinion of American management the efforts which are being made to control development expenditures assist in keeping expenditure down and in making development engineers cost conscious.

Relations between Accountants and Shop Administration

The friendliness and understanding between the controller's department and the shop supervisors are remarkable. Everyone connected with shop management looks upon the controller's department as an essential service to production and not merely as outsiders charged with putting a curb on expense. The amount of technical knowledge in cost offices is remarkable, and many accounting executives have had a technical as well as a professional training.

Job Evaluation and Time Standards

In almost every plant visited production jobs have been evaluated to compare with one another and to enable reasonable labour rates to be negotiated with the union.

Nearly all plants also employ experts in time study, who not only provide standards for routine operations but also produce comparative estimates of the possible savings effected by the introduction of new methods or new machines.

Labour control is mostly exercised through standard times, which are compared with the actual time taken to show the efficiency of individual men.

Scrap is controlled with great care because it is considered a waste of valuable production time and of material.

Inspection

Inspection generally appears to be kept to the minimum necessary to maintain the required quality. If the reports on a piece part or process show over a period of time that rejects are few, inspection will be removed. Investigations are often made of the cost of inspection compared with the cost of allowing a certain percentage of reject parts to pass to the next stage of manufacture. In this way a close control is maintained of inspection costs.

Continuous sampling schemes and statistical quality control methods are in use in many factories, and it is common to find the inspection department under the jurisdiction of the quality control department.

Costing

Cost consciousness is the outstanding feature of the American industrialist, and the industrial accountant has been called upon to play a great part in the management of American industry as adviser and counsellor. The one aim of the industrial accountant is to serve management, and he designs his whole system of records and reports to this end. The controller's personal touch with the management is very close, and he gets into the habit of thinking in its terms. His approach to figures therefore is to look ahead rather than back, and he is constantly making special reports on particular subjects, either on his own initiative or at the management's request. He is prepared to sacrifice bookkeeping accuracy in order to get quick results.

There is no standardization in the type of cost system the American accountant uses. Nearly half the firms investigated used a system of standard cost control in the form generally associated with this title, but many more use some form of standards, forecasts, or budgets as a guide to efficiency. In general, there is

no distinction between financial records and cost records. Accounting is one integrated whole with the controller at the head of the department, supported by two sectional chiefs in charge of the costing and of the accounting records.

Education For Management

The realization that men need training before they can become good managers led at the turn of the century to the establishment of schools of business in a number of America's leading universities. The success and rapid growth of these schools has in a large measure been due to their close cooperation with the business world. The policy of the schools of business is to find out what is required of managers and then attempt to supply it.

(*a*) *Harvard School of Business Administration*

The dean is a director of several large industrial enterprises and in this way keeps in close touch with the business world. Many of the professors have had experience in business with which they maintain constant contact through gathering case histories and undertaking research, and all members of the faculty are expected to spend on an average ten hours a week in outside consulting activities. Much of the time they are not teaching but doing.

The graduate course is of two years duration. The first-year course of study consists of one integrated course — Elements of Administration — broken down into six subjects: marketing, production, finance, control (the use of figures in administration), administrative practice, public relationships, and responsibilities. In the second year the student chooses a field of interest to him and explores it further. Over-specialization is discouraged and each second-year student is required to take a course on administrative policy, which stresses:

(a) Diagnosis of business situations wherein the real nature of the existing business problem is not obvious and can be found only by the able executive. The problem is set to the classroom which forms a discussion group presided over by the instructor, and emphasis is placed on drawing from each student his appraisal of the problem and his solution based upon the evidence submitted.

(b) The functions of top business executives who must coordinate all phases of a business into a successful and happy going concern.

The advanced management program is an intensive course of study for experienced executives, intended for men who have been sent by their own organizations and are considered by top management to be capable of assuming greater administrative responsibility in the future with those organizations. The course is of more than 12 weeks duration and, using case studies, provides concentrated study in appropriate subjects.

(*b*) *Massachusetts Institute of Technology*

A four year course has been developed in which students are given a good grounding in basic engineering. Following this they are taught business administration. The object of the whole course is to train students to become able administrators of technical units. The students are taught how to make intelligent use of accounting data. However, Massachusetts Institute of Technology is primarily an institution for training technicians, and only one in ten of the students chooses the more general field of industrial administration.

The Faculty of Industrial Engineering at Columbia University and the Chicago University School of Commerce were also visited and brief comments made on the work carried on there.

Conclusions

The team summarized its conclusions as follows:

1. The most significant factor in America leading to high production at low cost is efficient management. Americans are always ready to make use of technical advances to improve their efficiency, realizing that only so can they raise the standard of living. This readiness is all the greater since the strict enforcement of the anti-trust laws prevents the growth of price agreements, quotas, and restrictive practices.

2. American managements are continually looking towards the future. They appreciate the need to base their decisions on factual information about the past and present and on reasoned forecasts of the future.

3. Their method is to set themselves targets which are as high as appear from facts and forecasts to be capable of achievement.

4. They are continually measuring their actual results against the target they have set themselves.

5. They have no hesitation in changing plans, methods, procedures, or organizations, if they think they can get nearer their target by doing so.

6. They have equally no hesitation in changing their target if changing circumstances make it unattainable or too easily attainable.

7. Responsibility is decentralized to the limit.

8. The responsibility of each manager, to the level of foreman, is clearly defined in terms of functions, results, and expenditure for which he is responsible.

9. Two main uses of accounting and costing information can be distinguished: for planning and for control.

10. For planning, forecasts are needed both of the trend of outside events beyond the control of management and of the probable results of alternative courses of action.

11. For control, actual results must be compared from time to time with set targets to see whether plans are working out successfully or whether changes in policy are needed.

12. It is the means of control provided by the accounting and costing function which enables decentralization of responsibility to be carried out so thoroughly and effectively.

13. Plans are translated into budgets and budgets broken down into targets for individual managers and foremen. The results achieved by each manager and foreman are frequently compared with the set target.

14. There is a difference in the use made by senior and junior management of accounting information. Senior management spends much more of its time considering the future and studying forecasts and budgets for the purpose of planning and setting targets, whereas junior managers are more interested in studying recent actual results in comparison with budgets as a guide to immediate action.

15. There is a difference between the type of report to boards of directors and executive officers. The boards of directors expect and receive voluminous financial information every month. Although many of the officers and senior executives also receive board reports, they do not regard them as the main source of control information.

16. The controller in many companies makes every effort to keep routine reports to executives to a minimum. He and his staff devote more and more time to the compilation of special non-recurring reports on subjects which are occupying the attention of management.

17. Long elaborate written reports are avoided. Much of the most valuable in-

formation passes in personal contact between the controller's department and all levels of management.

18. The controller has a good understanding of management problems and technical processes. He is always kept fully informed as to what is going on in the business.

19. The speed and service which the controller gives to the management are outstanding and impressive. Practically every company uses some form of budgeting, although it is often called by other names. Some form of standard costs is in use more often than not. Historical costing was seldom found.

20. Rather than use elaborate flexible budget techniques, it is the practice to set long-term budgets for cost ascertainment and prices, and during the lifetime of this budget to set many short-term budgets which are used for control purposes. Technically this means, of course, budgeting for a variance.

21. Managers and industrial accountants are conscious of the gap between management and accountancy and of the need to bridge this gap. On the whole they have succeeded far beyond the normal achievements in Britain.

22. Management is convinced that academic training for business is worthwhile and supports in every way the graduate and undergraduate schools of business. The quality of the staff employed by the schools is high. They are practical men in close touch with industry and are expected to spend a proportion of their time doing consulting work lest they become too academic.

23. Office organization is noteworthy. The office is obviously considered to be just as important as a production department and the same care is given to organization of staff, planning of work, and physical conditions.

24. As distinct from shop labour, clerical labour is trained to do several jobs and is flexible, making for considerable economy of effort

Books Received

Memoria de la Segunda Conferencia Interamericana de Contabilidad; published by Patronato para el Fomento de la Contabilidad en Mexico, A.C.; pp. 784, photographs and index; price $60 (Mexican)

This imposing volume contains the reports and resolutions of the Second Pan-American Conference on Accounting which was held in Mexico in 1951.

The Michigan Business Receipts Tax, by Peter A. Firmin; published by the School of Business Administration, University of Michigan; Ann Arbor, Mich., 1953; pp. 149; price $2.00 U.S.

The business receipts tax imposed by Michigan in 1953 is purported to be the first attempt in the United States to base a tax on the value which a business endeavour adds to a product, commodity, or service. The author makes comparisons with business taxes in other States and then studies the impact of such a tax on different kinds of business activity.

An Administrative Case Study of Performance Budgeting in the City of Los Angeles, by George A. Terhune; published by the Municipal Finance Officers Association, Chicago; pp. 32; price $1.25

Here in detail is the procedure which a municipal organization has followed to introduce performance budgeting, sometimes called program budgeting, into its various departments and agencies.

Formal Education And Internal Auditing

By S. G. Hennessey, B.Com., C.A.
Institute of Business Administration, University of Toronto

Narrow technical training is not sufficient for the internal auditor who is to play his part in management

EDUCATION for business responsibility in political democracies, of which this subject is a part, has been generally recognized as a great challenge only during the last few years. This recognition has come about in part as a result of the very great pressures which have been placed upon private ownership and the profit motive during the past decade. The developments in education for business which have taken place and which are presently planned reflect the willingness of business organizations to examine the changing needs of the business community.

Formal Education and Staff Training

Business education is often broken into two parts, "formal education" and "staff training". In brief, this division seems to me to recognize, first, the role of the established educational institutions and, secondly, the responsibilities which must be assumed directly by business for the development of suitable staff. While this separation is useful for some purposes it should not be stressed unduly since there is a single common objective, and the same people are under consideration in each case. Also, it seems to me, the two must be more closely related if each is to be most effective.

Education has to do with the development of character, with the strengthening of mental powers, with the improvement of perspective and perception; training is more nearly related to technical knowledge and ability, to the acquisition of skills which are very often physical in nature, to the acceptance of established routines and objectives. The two are, however, closely related and run together. Education may be "formal", that is in association with an educational institution; or it may be "informal", the result of individual effort and arrangements of many kinds, through reading, travel, study groups, and so on. For some people the educational process ends substantially when they "leave school"; for others it is a continuous life-long process on either or both of a "formal" or "informal" basis, as the terms are used in this paper.

Formal education may be discussed as primary, secondary, and advanced,

A paper read to the North-east Regional Conference of the Institute of Internal Auditors, Toronto, October 1953

and each is important, of course. In this paper attention will be focused at the university level since this is the one with which I am most familiar.

Staff training includes a great variety of activity undertaken by any organization to improve the qualifications and performance of its employees. Much of it is specific and technical and an essential part of the process whereby effective and productive employees become available.

Internal Auditing

Now, let me make two specific statements related to internal auditing and the internal auditor: first, the internal auditor is a member of the management group, and, secondly, the formal education which is appropriate to internal auditing is not very different from that which is suitable for other managerial positions.

The first of these statements need hardly be emphasized. The internal auditor is an administrator. He participates in the formulation of policy decisions as a part of the administrative control mechanism. The internal auditor is a member of the staff, as opposed to line, organization,

With my second comment you may not agree so readily; you may feel that very special educational arrangements are necessary for internal auditors, even though you accept my first suggestion. Much of what follows is in support of this second contention, i.e., no elaborate special educational arrangements seem to be necessary for a useful career in internal auditing — the basis which is appropriate for most business careers is suitable here too. As initial support for this claim I would state that the internal auditor frequently has unusual opportunity for advancement. Because of the confidential nature of many of his duties, his company-wide point of view, and his association with every aspect of the life of the organization, he is very likely to be considered when senior appointments in the line organization are being made. Moreover, the internal auditor is today expected to have a comprehensive point of view, not a narrow technical approach to his work. I suggest therefore that it is unlikely that two very different educational backgrounds are necessary.

Education for Management

Let us now direct our attention to the more general question of "education for management". In recent years much energy has been devoted by many able people in an effort to understand the problems involved in providing executive leadership in a free society. Formal education has received much attention in this connection. Let us examine two or three of the basic problems briefly.

What should be the nature of the formal education of those men and women who plan a career in business? This question should be of fundamental interest to businesss men and educators alike. Consideration of it leads quickly to other questions: does business need men and women with a broad basis of education? If there is to be some or a lot of specialization, at what point should this begin? To what extremes should it go?

The internal auditor might ask these same questions more directly: what background is best for the young people who come into my department? How much should they know about accounting, auditing, law, and the theory of administration when they leave school? How much can educational institutions assist in their development and progress after they come to me?

In answering, we must keep in mind some of the important characteristics of modern business in our society. One dominant feature in recent years has been ever-increasing specialization, the subdivision of functions. Inevitably this has created acute problems of coordination. Businessmen are narrowing their range of vision by specializing at a time when the need for a broad view and understanding is increasing in importance. I am sure that these statements are sufficient reminder of the ever-increasing complexity of business life and of the importance of effective communication in it.

There seems to be growing agreement among administrators and educators that formal education should be of a general nature. Many recent reports make clear that young people going into business, industry, government, or the services should be encouraged to develop analytical, critical attitudes, that they should strengthen their ability to think and to express themselves orally and in writing. Many investigators have concluded that formal education should provide a background against which young people will be able to assume specialist's duties without serious loss of perspective. A fitting preparation for business life must allow them to see clearly their own position in their organization and in society. As an example, the Institute of Chartered Accountants of Ontario in a brief to the Royal Commission on Education in Ontario submitted in part: "Those who enter the field of professional accounting should have a general rather than a vocational training at school. Specialization should come after they leave school . . . emphasis should be on the man and his general background, not in terms of specialized knowledge and training."

Admitted to the Ontario Institute in 1946, Professor S. G. Hennessey, B.Com., C.A. is at present a member of the staff of the Institute of Business Administration, University of Toronto. He is director of the management conferences conducted by the University and is associated with a variety of activities related to the development of executives.

Through emphasis on formal education of a general nature we may secure a more constant flow of young people who are able to progress, very often through the internal audit section, to positions of major importance. In this way the worst effects of specialist duties, which are almost inevitable early in every career, may be minimized. Appropriate education should mean that each specialist assignment adds to a man's ability to see each specialized responsibility in its relationship to all others. This ability is essential in any senior administrator.

Subject Matter

This leads us to a consideration of the specific subjects to be studied by young people going into business.

From what has just been said it seems to follow that any broad course of study, so long as it includes subjects of true cultural significance, would be valuable and appropriate. I am sure, for example, that history, languages (particularly English), art, and philosophy are entirely appropriate to the formal education of a young man going into business. Such studies will develop critical attitudes, ability to communicate, and a sense of proportion, and these qualities, I have already suggested, are fundamental to a useful career in business, whether as an internal auditor or the president of a bank or of a large manufacturing establishment.

Of course these subjects in the liberal arts tradition do seem to provide only an indirect approach to the development of internal auditors or of administrators with general management duties. It may be suggested that studies more closely related to business are as likely to develop the qualities which I have just mentioned, and at the same time provide much more of the type of background which will enable the newcomer in business to play his specialist roles intelligently and go on to more general duties of co-ordination in due course.

With these suggestions I will not quarrel. Studies in mathematics, economics, law, accounting, and business organization will certainly develop those qualities which we have said are vital, and these subjects are usually regarded as basic to any course in business administration or in commerce and finance. Most businessmen and many educators, but not all of them, would accept them as part of a reasonable program of formal education. Real differences of opinion become apparent when the degree of specialization in technical subjects and the stage at which specialization begins come under discussion.

The extremes are these: first, the *undergraduate* course in business administration where a very substantial part of the time available is devoted to, let us say, accounting in its various branches; secondly, the course for *graduate* students wherein no concentration of study is encouraged and some familiarity with all aspects of the administration process is required. Most business schools establish their curriculum between these extremes.

From my earlier remarks it is apparent that the second extreme is closer to the desirable mark in my opinion. If you seek as your subordinates those who have broad perspective and ability to weigh the relevance of evidence effectively you will probably agree; you will agree more readily if you desire that your subordinates shall cease to be narrow specialists at an early stage in their careers. My conclusion is this: the objective in formal education must be more fundamental than the organization of marketable skills and knowledge.

As another example of the comment which seems most representative to-day, *Fortune,* April 1953, had this to say in an article titled "Should a Businessman be Educated?":

> U.S. business is talking a great deal these days about its need for more broadly educated men. It wants more men who have acquired the range of interests and the mental disciplines that education in the liberal arts or humanities is peculiarly well fitted to give. More and more frequently U.S. business men are heard to say that they can (within certain obvious limitations) create their own "specialists" after they hire them, that what they need and can't create is men with a decent general education.

Education: A Continuing Process

The educational process must not end at graduation. Everyone has heard this statement dozens of times, and perhaps we are wise to keep repeating it. Sir Richard Livingston in 1947 spoke of "the deadly heresy that education must be completed in school and university, that this is our last chance of learning, and, therefore, that we should be crammed with all the food of knowledge needed for the journey of life — the true fact is that education should send us into life knowing thoroughly something which is itself first rate, knowing how to learn, and interested in the world".

When we speak of education as a continuing process we should have in

mind two possible courses of action. Each should be accepted and allowed to contribute to our further progress. The first is "informal" and has to do with the efforts which people make to educate themselves, by reading, attending various conferences, by study groups and lectures, by intelligent and constructive conversation, and so on. The other is in the nature of an extension of the "formal" kind through continued association with the established educational institutions beyond graduation. This second suggestion includes participation in all of the programs offered by educational institutions. Some of these are of direct importance in our present discussion of formal education for business. In this extension of formal education, far beyond the time at which a person leaves school and enters business or government, I see much hope for the future of education for business.

Let me briefly outline our experience at the University of Toronto; it is not very different from that at the University of Chicago and elsewhere.

Provision has been made for part-time studies in the Institute of Business Administration in a variety of ways. University graduates may proceed toward a Master's Degree; any serious student, graduate or not, may take part in one or more phases of what is known as the conference series; for seasoned administrators there is an executive program.

This part-time program has grown quickly; both the university and the business community are pleased with the results. Participation in this program does not remove the need for company-planned staff training arrangements. The university cannot do many things which are possible on an in-plant basis; on the other hand, the university can do much which is not possible for any single business organization but is of significance in the development of well-balanced administrators.

This extension of formal education is already well recognized as an important innovation in the field of education for business. It merits serious consideration because senior administrators have important responsibilities to their subordinates in guiding and planning their development.

Finally, businessmen and educational institutions must work together and plan carefully if they are to make the best possible use of the human resources which we have so recently recognized as the dominant ingredient in our economic structure. I would encourage accountants and businessmen to make their views known and to continue their interest in the subject of education for business responsibility.

Professional Notes

NEWS FROM THE C.I.C.A.

Magazine Articles on Income Tax

Early in February the C.I.C.A. was asked if it could be instrumental in obtaining an article on "How to Prepare Your Income Tax" for publication in *The Canadian Jeweller*. Since very little notice was given before the deadline date, the article was written by C. L. King, the executive secretary of the C.I.C.A. The article was considered suitable for other publications as well and appears in the March and April issues of *The Canadian Baker, The Motor Magazine, The Canadian Cigar & Tobacco Journal,* and *Truck Transportation.* The combined circulation of these publications is in excess of 35,000 readers.

ALBERTA

Clarkson, Gordon & Co., Chartered Accountants, 808 Lancaster Bldg., Calgary, announce the admission to partnership of Mr W. Barry Coutts, C.A.

BRITISH COLUMBIA

Munn, Richards, Yeoman & Co., Chartered Accountants, announce the removal of their Vancouver office to 220 Pemberton Bldg., 744 W. Hastings St., Vancouver.

ONTARIO

The Public Relations Committee of the Ontario Institute held a dinner meeting on March 25 for senior guidance teachers of secondary schools in and around Toronto. At that time the Institute's film strip "Careers in Canadian Accountancy" were shown, and a discussion was held on the opportunities for young people in this type of work. A complimentary copy of the film strip and accompanying manual has been sent to each Institute. Additional copies are available from the Ontario Institute at $5.00 each.

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Clarkson, Gordon & Co., Chartered Accountants, 15 Wellington St. W., Toronto, announce the admission to partnership of Mr Ross M. Skinner, C.A.

Hamilton and District C.A. Association

Mr F. W. P. Jones, newly appointed dean of the School of Business Administration at the University of Western Ontario and former president of Hobbs Glass Limited, addressed a well attended meeting of the Hamilton and District Chartered Accountants Association at Fischer's Hotel on March 10. He spoke on "Ten Management Misses" and in so doing exploded a number of popular misconceptions. Among other things he criticized blotters as an advertising medium because of the fact that 50% of pens now write dry.

A. W. Parish introduced the speaker and K. Smith moved the vote of thanks. Chairman for the evening was R. B. Taylor.

At the same meeting cash prizes were presented by Lawrence Johnson, chairman of the Students Education Committee, to David W. Lay, Arthur Headland, and Douglas E. Perrin who came highest in the primary, intermediate, and final examinations, respectively.

PRINCE EDWARD ISLAND

On Friday, March 5, the Institute of Chartered Accountants of Prince Edward Island held its semi-annual dinner meeting under the chairmanship of R. W. Manning, president. Prizes for the 1953 examinations were awarded as follows: *primary* ($10), J. N. Arsenault; *intermediate* ($25), David A. Andrew; *final* ($25), H. Raymond Hennessey.

QUEBEC

M. Andre J. Dolbec, c.a. a le plaisir d'annoncer l'ouverture de son bureau à 16, rue St-Joseph, Quebec où il pratiquera sa profession avec Jean Dolbec, c.a. sous la raison sociale Dolbec & Dolbec, comptables agréés.

News of Our Members

Dr Francis G. Winspear, F.C.A. (Alta.; B.C.; Man.), has been appointed director of the school of commerce and professor of business administration at the University of Alberta.

* * *

Mr R. M. Bain, C.A. (B.C.), has been appointed controller of O'Brien Advertising Limited, Vancouver.

* * *

Announcement is made of the formation of the firm of Ronald D. Smith & Co., members of the Toronto stock exchange. Partners are Messrs Ronald D. Smith and K. W. Dalglish, F.C.A. (Ont.), C.A. (Que.).

Mr R. E. A. Lindsey, C.A. (Ont.), has been appointed comptroller of Rolph-Clark-Stone Limited, Toronto.

* * *

Mr C. E. Wesson, C.A. (Man.), has been appointed director of taxation for Victoria, B.C.

* * *

Mr J. D. W. Blyth, C.A. (B.C., Sask.), has been named a commissioner of the three-man B.C. Power Commission.

* * *

Mr D. A. B. Murray, C.A. (Man.), is the new chairman of the Greater Winnipeg Industrial Development Board.

Accounting Research

By Gertrude Mulcahy, B.A., C.A.
The C.I.C.A. Research Department

1952 FINANCIAL STATEMENTS

DURING the past year the Committee on Accounting and Auditing Research of the Canadian Institute of Chartered Accountants has presented in this column highlights of financial reporting in Canada. It was hoped that this information, based on the analyses of the 1949, 1950, and 1951 annual financial reports of a group of Canadian companies, would be of assistance in furthering the "marked and steady improvement in the quality of financial reporting" in this country.

Continuing this policy of analysis of financial reporting, in order to bring to light significant trends in statement presentation and in accounting principles, the research staff of the Canadian Institute of Chartered Accountants has undertaken a study of the 1952 financial reports of 280 Canadian companies. The companies included in this current study were the same as those included in the 1951 analysis, although 15 new companies were introduced to replace those for whom 1951 financial statements were not available.

The companies whose 1952 annual reports were included in the detailed analysis were classified as follows:

20	Beverage industries
22	Construction industries
41	Merchandising industries
33	Foodstuff industries
8	Grain and milling industries
73	Iron and steel industries
29	Sundry processing and distributing industries
25	Pulp and paper industries
29	Textile industries
280	

In addition, some 100 annual reports of public utility companies, banks, trust companies, mining companies, etc. were informally reviewed for irregularities and inconsistencies.

Accounts Receivable

Segregation of Types

All of the financial statements reviewed, except three in 1952, two in 1951, one in 1950, and one in 1949 included accounts receivable of one kind or another in current assets.

In general, the term "accounts receivable" relates to amounts due as a result of business transactions with individuals and concerns not a part of or associated with the business itself. Contrary to the recommendations contained in Bulletin No. 1, many of the financial

statements failed to segregate the various types of accounts receivable but grouped such items as trade accounts receivable, advances owing to officers, notes receivable, deposits on purchase contracts, and advances owing from affiliates. Examples 1, 2, and 3 clearly set out the dollar value attributable to the various types of accounts receivable. However, in example 4 the segregation of "Accounts Receivable-Employees-$388" does not have any real significance in relation to the total of the accounts receivable, but adds unnecessary detail to the financial statements. In examples 5 and 6 the reader cannot determine from the information given whether the notes receivable in example 5 and the prepaid expenses in example 6 are significant in amount, which might be the case since they are mentioned specifically, or insignificant in amount and grouped with accounts receivable for simplicity.

Disclosure of Doubtful Accounts

In Bulletin No. 1 the Committee on Accounting and Auditing Research recommended that if the allowance for doubtful accounts is not shown separately on the balance sheet there should be an indication in parenthesis or otherwise that such an allowance has been deducted.

Figure 1 shows the extent to which Canadian accountants have accepted and applied this recommendation. The most preferable form of statement presentation, which is to show both the amount of the accounts receivable and the amount of the allowance for doubtful accounts, is set out in each of examples 1, 2, and 4. Examples 3 and 5, while not revealing the exact amount of the allowance, conform with the recommendations of Bulletin No. 1. The readers of the financial statement from which example 6 was taken, and of the other financial statements which make no reference to allowance for doubtful accounts, are justified in assuming that the amount stated is believed to be collectible within the period usual to the particular trade or industry.

Terminology re Allowance for Doubtful Accounts

Although the officers of Canadian companies still prefer the term "reserve" in describing the allowance for doubtful accounts, Figure 2 indicates that in this particular instance the efforts of the Committee on Accounting and Auditing Research to limit the use of this term in

Figure 1

BALANCE SHEET DISCLOSURE OF ALLOWANCE FOR DOUBTFUL ACCOUNTS

1952	1951	1950	1949	
53.8%	50.5%	54.3%	55.2%	Allowance indicated but no disclosure of exact amount of allowance
14.1%	16.3%	15.9%	24.4%	Amount of allowance set out as a deduction from accounts receivable
14.4%	14.4%	12 %	5 %	Amount of allowance set out in description of accounts receivable
.7%	1.1%	1 %	1 %	Amount of allowance set out on the liability side of the balance sheet
17 %	17.7%	16.8%	14.4%	No reference to uncollectible accounts
100 %	100 %	100 %	100 %	

Figure 2

TERMINOLOGY RE ALLOWANCE FOR DOUBTFUL ACCOUNTS

1952	1951	1950	1949		
67.4%	83.7%	85.8%	87.8%	—	reserve
18.3%	4.8%	2.5%	1.1%	—	allowance
13 %	10 %	11.7%	11.1%	—	provision
.4%	.5%			—	estimated
.9%	1 %			—	amounts set aside to take care of
100 %	100 %	100 %	100 %		

order to avoid confusion have had considerable success. It is interesting to note in the 1952 analysis that the term "allowance", recommended in Bulletin No. 9 when considering the question of doubtful accounts, has outranked the term "provision" for the first time.

Since many of the 1952 financial statements had been prepared before the release of Bulletin No. 9 in January 1953, the true impact of the recommendations on the use of the term "reserve" will not be apparent until the 1953 financial statements are studied.

Of the excerpts from actual balance sheets, only examples 1 and 5 conform to the recommended wording.

Excerpts from Published Financial Statements (1952) — Accounts Receivable

Example 1

Accounts receivable:		
Trade	$278,426	
Due from employees	20,625	
	$299,051	
Less allowance for doubtful accounts	$ 22,251	$276,800

Example 2

Accounts receivable		
Trade	$989,560	
Notes receivable	7,091	
	$996,651	
Less: Reserve for doubtful accounts	40,942	
	$955,709	
Tender deposits on governmental contracts	17,626	$973,335

Example 3

Accounts receivable		
Trade (less reserve)	$661,633	
Miscellaneous	32,231	
Wholly owned subsidiary companies	443,804	$1,137,668

Example 4

Accounts receivable — Trade	$384,190	
— Employees	388	
	$384,578	
Less: Reserve for doubtful accounts	6,500	$378,078

Example 5

Notes and accounts receivable, less allowance for doubtful accounts $146,808

Example 6

Debtors and prepaid expenses $3,610,543

Marketable Securities

It has become generally accepted that the amount of securities which are considered to be readily convertible into cash and in which surplus funds of the company have been invested temporarily should be shown on the balance sheet under current assets. Securities which are not readily realizable either as a result of market conditions or business policy should not be included in current assets.

Of the financial statements analyzed, 122 in 1952, 136 in 1951, 113 in 1950, and 101 in 1949 have set forth securities in the current assets section. The readers of these balance sheets are entitled to assume that such securities are available for the discharge of current liabilities.

Basis of Valuation and Market Value

Figure 3 indicates the extent to which the basis of valuation and market value of marketable securities are disclosed. In the majority of cases Canadian accountants follow the recommendations of Bulletin No. 1 in this respect. In addition, in 32.8% of the 1952 statements the management have recognized the importance of the realizable value of marketable securities in the current position and set out their market value, although not disclosing the basis of valuation.

The majority of those companies which stated the basis of valuation of these securities used the term "cost". Other bases such as "less reserve", "par", "cost less write off", "cost less reserve", "at less than present market", "book value", and "market" were also used.

Figure 3

BALANCE SHEET DISCLOSURE RE MARKETABLE SECURITIES

1952	1951	1950	1949	
57.4%	52.9%	54%	55.4%	Basis of valuation shown — market value shown
32.8%	30.9%	24.8%	26.7%	Basis of valuation not shown — market value shown
6.6%	10.3%	14.1%	11.9%	Basis of valuation shown — market value not shown
2.5%	5.1%	7.1%	6 %	Neither basis of valuation nor market value shown
.7%	.8%			Basis of valuation shown — reference to "market"
100%	100%	100%	100%	

Examples 7 and 8, which clearly indicate both the basis of valuation and the market value of investments considered to be readily realizable, present to the reader sufficient information to assess the significance of these items in the liquid position of the company.

Example 9, while not disclosing the basis of valuation, sets out its market value and an unusual item: "company's own bonds included therein"; presumably the inference is that these bonds are held temporarily pending reissue.

In example 10 it is not clear whether marketable securities are valued at cost or at market and, correspondingly, whether the reserve referred to is calculated with reference to the cost or the market value of such securities or to the investments.

The reader of example 11 would conclude that the management of the company does not anticipate the conversion of the marketable securities included under the heading "Investment" into cash to meet current liabilities whereas the bonds included under "Current Assets" represent a temporary investment of surplus current funds.

The balance sheet presentation of example 12 indicates that the securities owned by the company, although apparently of a readily marketable nature, are all held as a permanent investment. Such an interpretation is substantiated by the following comment included in the directors' report: "Investments of $1,-033,596.23 represent capital not immediately required for present operations."

Excerpts from Published Financial Statements (1952) — Marketable Securities

Example 7

Current Assets

Marketable securities—(quoted value $2,289,965)		
Short term secured notes at cost and accrued interest	$1,508,335	
Bonds at cost and accrued interest	737,686	
Shares at cost	99,875	
	$2,345,896	
Less reduction of book values to market quotations	55,931	
		$2,289,965

(Charge in statement of profit and loss before "net income for the year" "Provision to reduce values of securities to market quotations $55,931")

Example 8

Current Assets

Marketable securities at cost	$ 307,945
(Quoted market value $652,175)	

Example 9

Grouped with other current assets although no heading

Investment securities — Marketable	
Including $128,000 par value of our own bonds	$8,814,146
(Market value at December 31, 1952 $8,165,700)	

Example 10

Current Assets

Marketable securities and investments at cost, less reserve		$ 21,983	
Market value	$11,766		
Investments at cost	11,565		
	$23,331		

Example 11

Current Assets

Province of .... bonds and those of and guaranteed by the Government of Canada (market value $133,237)		150,973
Investments		
Marketable securities (market value $50,763)	$ 36,411	
Mortgages	126,733	
Memberships	560	$163,704

Example 12

Investments

Government bonds and corporation bonds, share and short term notes — at cost, less reserve (quoted market value $1,073,653)	$1,033,596	
Revenue accrued to date	4,550	$1,038,146

Obituary

Emmett Curran

The Institute of Chartered Accountants of Ontario announces with regret the death of Emmett Curran on April 6, 1954 in Toronto, after a lengthy illness.

The late Mr. Curran was born in Toronto and educated at De La Salle School. He became a member of the Ontario Institute in 1937. During the second world war he served with the Department of Munitions and Supply as a district supervisor. Later he was controller for General Engineering Company of Canada. For four years he was director and secretary-treasurer of Stafford Industries Limited. He joined Kingsway Lumber Limited in 1949 as secretary-treasurer.

He was a member of the Society of Industrial and Cost Accountants of Ontario and belonged to Our Lady of Sorrow's Church in Toronto.

The members of the Institute desire to express their sincere sympathy with his widow and family in their great loss.

Practitioners' Forum

Conducted by Geoffrey H. Ward, C.A.

THE AUDITOR AND THE BANKER

ONE of the aims of this column is to attempt to give practical every-day help to smaller practitioners, who, generally speaking, service small business.

Many of these small businesses, although they have a respectable volume of sales and earn a reasonable return both on sales and capital, fall in the category of the "one man business". Management, insofar as it concerns manufacturing, production, sales, and finance, is the responsibility of one man — generally the man who owns most or all of the capital invested in the business.

At some time or other most businesses are unable to operate within their own cash resources and must of necessity obtain temporary financial assistance from a banker.

This is the type of situation in which the "one man business" may require the service or assistance of the smaller practitioner. In large businesses the personnel are qualified and are expected to carry out many negotiations without outside assistance. In smaller businesses such qualified personnel are not available, and the public accountant is called upon to provide assistance and guidance in matters not directly related to auditing.

There are several recent articles which may be of assistance in considering this subject.

Accountants and Bankers Help Each Other to Help their Clients

Mr. Alvin R. Jennings, C.P.A., reports in the June 1953 issue of *The Journal of Accountancy* on a program of cooperation with bankers which has helped the practitioner serving small business. The American Institute has a long-term program to improve relations between bankers and public accountants. Many bankers, through the Robert Morris Associates, have done a considerable amount of work in this area and have issued an excellent pamphlet "Financial Statements for Bank Credit Purposes".

The American Institute's program has had three purposes:—

1. To identify standards of auditing for guidance of members of the profession;

2. To promote compliance with the standards;

3. To place at the disposal of bankers and other credit grantors informa-

tion which will assist them in understanding the objectives of auditing and in interpreting auditors' reports.

The American Institute's committee on cooperation with bankers concerns itself with the third of the above goals. Indications are that a great deal of progress has been made, e.g. a survey has been conducted to discover the degree to which auditing practices throughout the country conform to approved standards. State societies have formed committees for cooperation with bankers.

The program for cooperation with bankers is expected to achieve many things important to most accountants, in particular to practitioners with smaller practices. Appreciation on the part of bankers that audits of adequate scope contribute greatly to sound banking will result in an increased demand for auditing services. Further education of bankers on auditing matters, particularly in the field of auditing standards, will promote more discriminating appraisal of auditors by the bankers. The Institute has made the point that the selection of accountants should be based solely on the quality of work done and not on the size of the accountant's practice.

Practising accountants can do much to develop these relations. Every accountant could make it a policy to visit the bankers in his respective area more frequently. On such visits the American Institute's Committee suggests that copies of the various booklets prepared by the Institute and by the Robert Morris Associates be shown to the banker.

Apparently many bankers do not fully understand that the ordinary forms of financial statements are designed for general purposes and not specifically prepared for credit purposes. An accountant whose client's periodic financing is partly through bank borrowings might tactfully suggest that he be invited to be present when the client negotiates the loan. This provides a fine opportunity for discussing the banker's needs, and this way the financial statements and reports can be prepared to provide those details which are required by the banker. If the banker so desires, sufficient description of the scope of work done, particularly on accounts receivable and inventory, may be included in the report.

The article concludes by stating that it is true of bankers, accountants, and their mutual clients, as in so many other fields, that problems disappear when people sit down together to talk about them. Bankers who complain that an accountant's report is sometimes inadequate for credit purposes would have much less reason for complaint if they would inform the local auditors as to what they want. And the auditor can improve his own reputation with bankers and with his clients if he will take the trouble to find out what the bankers want.

Points for Loan Applications

In order to give every consideration to a loan application the banker must have facts, and to get those facts bankers encourage customers to turn to public accountants for correct and complete statements.

The proprietor of a small business with a well-organized set of books and financial statements will usually have little difficulty in providing his banker with concise and understandable statements of condition. A sound statement of accounts is not found in many small concerns, even in those which have been operating for some time. The absence of a good financial statement is usually the first basic evidence not only of a weakness in financial policy but also in over-all management skill.

In *The Journal of Accountancy,* June 1951, James F. Willett, vice-president, American Security and Trust Company, Washington, D.C., gives 16 points of information which a banker looks for in a businessman's statements: —

1. A certificate, stating the scope of the audit;
2. Comments on the balance sheet and supporting exhibits;
3. A copy of the balance sheet itself;
4. Summary of surplus changes;
5. Statement of profit and loss with supporting schedules.

   Balance sheet comments are very important and afford the accountant an opportunity to give a clear explanation of the various assets, liabilities, and equity items. It would not be a misstatement to say that today over 95% of financial statements of small business firms have no comment regarding the balance sheet.

   Items to be covered would include:

6. Cash, receivables, trade accounts receivable, other accounts receivable;
7. Merchandise inventory, classified as to finished goods, work in process, and raw material, and also giving the basis of valuation, such as lower of cost or market, Lifo, etc.;
8. Cash surrender value of life insurance, investments, tax refunds;
9. Fixed assets, the basis of valuation, gross amount and accumulated depreciation, indicating the method by which depreciation is computed and the rates used;
10. Current liabilities;
11. Notes payable should be classified as due banks, trade, stockholders, and others, and any restrictive terms should be disclosed;
12. Accounts payable, other than to trade creditors, should be explained as to terms and origins, and accruals such as interest, taxes, compensation bonuses, etc., should be set forth by the class of items;
13. Income taxes payable should be adequately explained, stating date of latest assessment;
14. Long-term liabilities due one year or longer should be defined as to maturity, dates, rates, restrictive provisions, and underlying security;
15. Contingent liabilities: an important item frequently not given consideration, yet it may have a serious bearing on the balance sheet;
16. Changes in net working capital. An item of particular interest is accounting for the factors affecting net working capital (otherwise known as a statement of funds provided and funds applied).

Finally, the auditor's comments should include a *résumé* of the insurance coverage as to type and amount. If a customer has not borrowed before or has not supplied the bank with a yearly audited statement, he should submit at least three statements in order that the person reviewing the application can get an indication of the general trend of the business.

The assistance of two panel members, A. F. Gosling, C.A. and one who wishes to remain anonymous, is gratefully acknowledged. More comments on this topic will appear in the next edition of your forum.

Readers are invited to comment on the material appearing in this department and to send in questions and observations which they would like to have discussed.

IMPROVING BUSINESS ENGLISH

An Experiment in a Professional Office

HERE is a report from a successful firm of chartered accountants on a topic of interest to everyone. One cannot help but admire their constructive approach to this problem. Quite a contrast with the do-nothing approach so many of us are guilty of!

"Some years ago we decided to try an experiment. We realized that the quality of the written material leaving our office often left much to be desired and we determined to do something about it. Of course our problem was not unique. The poor standard of English used by business and professional men generally is a popular object of derision, and the schools and universities usually get the blame. However, we did not know of any practical efforts having been made by Canadian employers to improve matters, and therefore any plan we adopted would be quite an innovation.

"We considered sending the staff to classes but decided that it would be foolish to try to add to the already overcrowded schedule that is the lot of every accountant and student accountant. Furthermore, after reading Sir Ernest Gower's booklet "Plain Words (A Guide to the Use of English)" we were persuaded that what we needed was not so much more study and more rules as a disinhibiting process, a means of clearing our minds and gaining the courage to write simply, using our knowledge of grammar to serve rather than confuse us. So it was agreed that we should engage someone to tackle our problem on a straightforward secretarial basis, someone who would work day by day on our actual letters and reports as they were being produced. We appointed a girl with a good working knowledge of the English language, some writing and teaching experience, and a manner that would be acceptable to all levels of our staff. Each morning she examined copies of the letters written on the previous day and noted her suggestions and comments in red ink. The copies were then returned to the author as well as to the person who signed the letter without regard to whether the writer was a senior partner or the newest student on the staff. Our method of dealing with reports and letters containing opinions was to have an extra copy typed at the drafting stage. Then, while the auditors were doing their revision, our editor got busy on a spare copy, marking her suggestions and criticisms and when necessary retyping whole sections that seemed to her to be beyond repair. In order to ensure that the amendments were read and noted and also to guard against alterations in sentence construction inadvertently changing the sense, it was a firm rule that every draft must be returned to and studied by its author.

"All this fitted quite conveniently into the normal office routine and even though the time we were able to devote to polishing and patching was necessarily very limited, an improvement in our English definitely did take place. We were jolted into realizing how much a little extra thought and care could achieve. The presence of a critic who would read with a layman's eye convinced us of our great responsibility to give our clients not only the best accounting but also the best reporting of which we are capable.

"Our editor is now at home teach-

ing basic English to a very new Canadian and the daily reviews have ceased, but the influence remains. Every member of the staff is now fully aware that the firm expects a high standard of writing and never again shall we join the moaners who bewail the quality of business English but assume that nothing can be done about it."

A Letter from a Reader

Edmonton, March 25, 1954

CANADA'S FOREIGN TRADE POLICY

Sir: I found the article by H. R. Sanders on Canada's foreign trade in the March issue very interesting and wish to make the following comments.

The terms "favourable trade balance" and "unfavourable trade balance" have more political than economic significance. The fact that Canada will have a so-called "unfavourable trade balance" for the year 1953 reflects heavy American investment in this country. Indeed the only way we could have a net foreign investment in our country for any year would be to have an "unfavourable trade balance". Whether it is desirable to have outsiders making heavy investment in our nation is another question, but I feel that it is possible to make a case that we are benefiting from it.

Our unsold wheat inventories may be causing concern. The same problem caused concern in the 1930's despite much lower production and despite the "Atlantic Triangle".

There is no "dollar gap" between Canada and the U.S.A. The "unfavourable balance" is offset by American investment. That is why the Canadian dollar has been running at a slight premium. Considering the much higher level of U.S. annual investment in Canada there has been a relatively modest increase in American share of our total imports since 1939 (from 66% to 74%).

Michael A. Heilperin is quoted with approval to the effect that "in a free market economy exports and imports originate spontaneously in the operation of many markets and in independent decisions of thousands and millions of individuals . . . all trade reflects division of labour, specialization . . .". If we accept this, we can only presume that our present trade with the U.S.A. is based on this "logic of commerce" and therefore no action is necessary or possible. Changes will be made automatically when they are in order.

It is true that a depression in the United States would have devastating repercussions throughout the free world. A return on our part to pre-war trading habits would afford no insulation as the events following 1929 will confirm.

I am not at all optimistic that Russia and Red China would prove to be more stable nations with which to trade. I would doubt that large, sustained exports from North America to these countries are possible in the foreseeable future. There can be no governmental or private investment from abroad in Russia or China. A necessary corollary of large exports would in the long run, therefore, have to be, directly or indirectly, large imports. The opposition on the part of management and labour to sizeable imports from behind the Iron Curtain would be just as sharp in Canada as in the States. In addition there are institutional factors which, to say the least, tend to make trade with these countries uninteresting.

Fortunately or unfortunately, the entire free world is largely dependent on American political and economic stability. With patience and cooperation on the part of her allies it is at least possible that the United States will meet the challenge.

J. W. CROWE, C.A.

The Students' Department

J. E. Smyth, C.A., Editor

(*Correspondence with the editor is cordially invited*)

NOTES AND COMMENTS

WHAT unseen hand is at work in England? We have before us a financial statement for Tate & Lyle Limited, the well-known English firm of sugar manufacturers, which points a new direction in the publication of financial information. The statement appeared in *The Spectator* of January 15, 1954:

TATE & LYLE, LIMITED

"Where all the money goes"

AN ANALYSIS OF INCOME AND EXPENDITURE IN 1953

DISBURSEMENTS

Goods and Services Purchased from Outside:—

	£	£
Raw materials (including Duty of £10,362,570)	83,740,382	
Fuel and power	1,264,760	
Packing materials	4,261,143	
Other refining expenses	975,387	
Advertising	50,839	
Overhead and special expenses, including selling and distribution	1,609,193	
		91,901,704
Value Added or Net Output:—		
Wages, salaries, national insurance and employees' benefits	4,884,691	
Provided for renewals of plant and machinery and depreciation of other fixed assets	1,045,366	
United Kingdom Taxation on profits and provision for contingent liability	1,967,742	
Amount placed to reserves	470,848	
Dividends to ordinary and preference stockholders (net)	656,898	
		9,025,545
Total Disbursements		£100,927,249

INCOME	
Value of export sales (including £5,619,548 drawback)	30,398,690
Value of home trade sales and other income	70,528,559
Total Income	£100,927,249

(The published statement has a further column at the right to show for each item, the "proportion of each £1 of income".)

Here indeed (and at last) is an accounting statement to warm the hearts of all economists. The major classification of "disbursements" as between (i) "goods and services purchased from outside" and (ii) "value added or net output" clearly reflects the influences of national income accounting. Estimates of national income include only the "value added" for each business because if "goods and services purchased from outside" were included, the same amounts would be counted twice in a consolidation of all businesses in the country.

Yet it is not enough that the form of financial statements of an individual business should please economists, worthy a motive as that may be; published financial statements must in the first instance be justified on grounds of their usefulness to those who have a direct interest, either as creditors or as shareholders, in the business. We must therefore ask whether the form of the above statement is as good for this purpose as any other.

In attempting an answer, we have to admit that the statement reproduced above is a curious one. Its publication in *The Spectator* was not accompanied by a balance sheet and it is itself neither quite an operating statement nor yet a statement of source and application of funds. To produce a figure for "value added" one has to add the profit for the year to the amounts of such expenses as wages and salaries, depreciation, and income tax. The result is a dollar figure to describe the contribution to the final product of all persons associated with the operations of this business (including the shareholders). In the above statement the profit for the year comprises the provision for contingent liability, the amount placed to reserves, and the dividends.

We think there is an advantage for a business in the publication of a figure for its "value added". It emphasizes the contribution of the company in question to the society in which it operates. The statement we have reproduced above goes a step further in this direction too, by breaking down the figure for total income as between export sales and home trade sales.

* * *

Our feelings about the Tate & Lyle Limited statement are only more poignant because we believe its rather obvious defects could have been avoided without altering the general form. Both the title ("Where all the money goes") and the main heading "Disbursements" imply that the statement is disclosing outlays of money; yet it is probable that at least some of the expense items include accruals, and neither the provision for depreciation, the provision for contingent liability, nor the "amount placed to reserves" involves any payment of money. One suspects that those who prepared the statement really wanted to use the term "debits" instead of "disbursements" but did not dare. The term "charges against revenue and disposition of profit", while not as brief as "disbursements", would have been more accurate.

A further defect is that it is not possible to compute profit for the year from the data of the statement because United Kingdom Taxation on Profits (generally considered an expense) is combined with a provision for contingent liability (presumably an appropriation of profit). But perhaps our objections merely expose our North American prejudices. The important thing is that the statement is an interesting experiment in the presentation of the results of operations.

PUZZLE

Jones, the general manager of a subsidiary corporation, was granted by the directors a bonus of 10% of the profit for the year after payment of the bonus and income tax.

Assuming that the subsidiary is not entitled to any relief on the first $20,000 of its taxable income and assuming that it has earned a profit of $38,000 (before bonus and income tax), what is the amount of the bonus that Jones will receive?

(Submitted by Mr. B. A. Campbell, Willowdale, Ontario in response to the editor's recent request for puzzles)

SOLUTION TO THE APRIL PUZZLE

Let "v" = my usual average speed in m.p.h.
and "t" = the time in hours I usually take to get to work.

Therefore, $v.t = 15$

or $t = 15/v$

The facts today are,

$$(v + 15)\,(t - 1/6) = 15$$
$$(v + 15)\,(15/v - 1/6) = 15$$
$$15 - v/6 + 225/v - 15/6 = 15$$
$$v/6 - 225/v + 15/6 = 0$$
$$v^2 - 1350 + 15v = 0$$
$$(v - 30)\,(v + 45) = 0$$
$$v = 30$$

My usual speed is 30 m.p.h. Today I travelled 45 m.p.h. *I did not break the speed limit.*

PROBLEMS AND SOLUTIONS

Solutions presented in this section are prepared by qualified accountants and reflect the personal views and opinions of the various contributors. They are designed not as models for submission to the examiner, but rather to provide such discussion and explanation of the problems as will make their study beneficial. The editor will welcome discussion of the solutions published.

PROBLEM 1

Intermediate Examination, October 1953

Accounting I, Question 2 (20 marks)

The G Co. Ltd., incorporated under the Companies Act, 1934 (Canada), acquired as at 31 Mar 1953, 70% of the outstanding shares of O Co. Ltd. for $1,000,000 cash. The following are the trial balances of the two companies immediately prior to the foregoing transaction:

TRIAL BALANCES
as at 31st March 1953

DEBITS

	G Co. Ltd.	O Co. Ltd.
Cash on hand and in bank	$ 1,500,000	$ 65,000
Accounts receivable	375,000	125,000
Inventories	800,000	300,000
Investments	200,000	
Fixed assets	1,000,000	1,150,000
	$ 3,875,000	$ 1,640,000

CREDITS

	G Co. Ltd.	O Co. Ltd.
Accounts payable	$ 525,000	$ 80,000
Bank loans payable		10,000
Bonds payable	500,000	350,000
Share capital authorized, issued and fully paid	2,000,000	900,000
Surplus	850,000	300,000
	$ 3,875,000	$ 1,640,000

Examination of the accounts of G Co. Ltd. showed that:
(a) Included in accounts payable was $75,000 for purchases from O Co. Ltd.
(b) Investments consisted of:

Government of Canada Bonds at cost	$100,000
Bonds of O Co. Ltd. at par	100,000

Required:

Consolidated balance sheet of the G Co. Ltd. and its subsidiary the O Co. Ltd. as at 31 Mar 1953 immediately after the purchase of the shares, prepared in accordance with good accounting practice. (Make any assumptions you consider necessary.)

A SOLUTION

G CO. LTD. AND ITS SUBSIDIARY O CO. LTD.
CONSOLIDATED BALANCE SHEET
As at 31 Mar 1953

ASSETS

Current		
Cash on hand and in bank	$ 565,000	
Accounts receivable — trade, less allowance for doubtful accounts	425,000	
Inventories — as determined and certified by the the management and valued at the lower of cost or market	1,100,000	
Government of Canada bonds at cost (market value $98,500)	100,000	
Total current assets		$ 2,190,000
Fixed		
Fixed assets — at cost less depreciation		2,150,000
Other		
Goodwill on consolidation		160,000
		$ 4,500,000

LIABILITIES AND CAPITAL

Current Liabilities		
Bank loans	$ 10,000	
Accounts payable — trade	530,000	
Total current liabilities		$ 540,000
Bonds payable — 5% due 31 Mar 1970	850,000	
Less held in treasury	100,000	750,000
Minority interest in capital and surplus		360,000
Total liabilities		1,650,000
Capital and Surplus		
Capital		
Authorized and issued — 200,000 shares of $10 par value each	2,000,000	
Surplus	850,000	
Total capital and surplus		2,850,000
		$ 4,500,000

Notes:

1. The goodwill arising out of the purchase of the controlling interest in O Co. Ltd. might be used to increase the dollar amount of the inventories or fixed assets of O Co. Ltd. if it were indicated that an appraisal had shown that the amount was understated on the books of the subsidiary.
2. The bonds payable might have been shown as a single figure, net.

EXAMINER'S COMMENTS

The chief reason for loss of marks was poor form, poor wording, and careless presentation.

PROBLEM 2

Final Examination, October 1953

Accounting I, Question 3 (20 marks)

H Ltd. has among others a shearing department and a cutting department. Each department has 4 machines and each pair of machines is operated by one operator who receives $2.00 per hour and two assistants who receive $1.35 per hour each. The plant superintendent, who earns $450 per month, spends 25% of his time in the shearing department and 10% of his time in the cutting department.

Each machine has a possible capacity of 160 hours per shift per month. The company operates all machines on the day shift, but the night shift consists of one operator and two assistants who operate two machines, one in each department.

The labour force is on hand and is paid for 160 hours per shift each month but it is estimated that the shearing machines will work only 70% of possible hours and the cutting machines only 90%.

The total area of the plant is 11,000 sq. ft. of which 2,750 sq. ft. is occupied by the shearing department and 550 sq. ft. by the cutting department.

Certain estimated expenses for the following year are given below:

Depreciation—building	$4,200
—shearing machines	3,400
—cutting machines	1,400
—delivery trucks	480
Property taxes	900
Insurance on building	720
Light and power	2,100
Coal	1,320
Fireman and watchman	3,600
Building repairs and maintenance	160
Factory supplies and expenses	4,250
Exchange and bank charges	675

Certain of the expenses are to be apportioned as follows:

	Shearing Dept.	Cutting Dept.	Building General
Light and power	20%	10%	10%
Factory supplies	10%	10%	20%
Spoiled work per annum	$55.00	$19.00	—

Repairs and maintenance are estimated at $180 per annum for each shearing machine and $150 per annum for each cutting machine.

Required:

Statement showing your calculation of the estimated rate per machine hour for applying factory service expense (overhead) in each of the shearing and cutting departments.

A SOLUTION

H LTD.

Shearing and Cutting Departments

Estimated Labour Cost for Year

		Shearing Dept.	Cutting Dept.
Operators —			
Day shift	4/2 x 12 x 160 x $2.00	$ 7,680	$ 7,680
Night shift	1/2 x 12 x 160 x $2.00	1,920	1,920
Assistants —			
Day shift	4 x 12 x 160 x $1.35	10,368	10,368
Night shift	1 x 12 x 160 x $1.35	2,592	2,592
Total labour		$22,560	$22,560
Non-productive labour — idle time			
	30%	6,768	
	10%		2,256
Direct labour		15,792	20,304
		$22,560	$22,560

H LTD.
Shearing and Cutting Departments
ESTIMATED MACHINE HOURS FOR YEAR

	Shearing Dept.	Cutting Dept.
Day shift:		
70% of 4 x 12 x 160	5,376 hrs.	
90% of 4 x 12 x 160		6,912 hrs.
Night shift:		
70% of 1 x 12 x 160	1,344	
90% of 1 x 12 x 160		1,728
Total machine hours	6,720	8,640

H LTD.
Shearing and Cutting Departments
ESTIMATED RATE PER MACHINE HOUR

Estimated factory service expense for year		Shearing		Cutting	Building
Non-productive labour — idle time		$ 6,768		$ 2,256	
Superintendent	(25%)	1,350	(10%)	540	
Depreciation		3,400		1,400	$ 4,200
Property taxes					900
Building insurance					720
Light and power		420		210	210
Coal					1,320
Fireman and watchman					3,600
Building repairs and maintenance					160
Factory supplies and expense		425		425	850
Spoiled work		55		19	
Repairs and maintenance to machines		720		600	
		$13,138		$ 5,450	$ 11,960
Allocation of building costs	(25%)	$ 2,990	(5%)	$ 598	
Total estimated factory service		$ 16,128		$ 6,048	
Total estimated machine hours for year		6,720		8,640	
Estimated rate per machine hour		$2.40		$ .70	

EXAMINER'S COMMENTS

Some candidates did not read the question carefully and (i) showed monthly expenses combined with annual expenses or (ii) included labour in the overhead rate.

PROBLEM 3

Final Examination, October 1953

Accounting I, Question 4 (20 marks)

Late in 1948 the A Co. Ltd. was formed and acquired the patent rights to an industrial machine. A wholly-owned subsidiary the B Co. Ltd. was also formed in 1948 to manufac-

ture the parts for the machines. These parts were sold to the A Co. Ltd. which assembled the parts and sold the machines.

During 1949 and 1950 the A Co. Ltd. sold 52,000 machines at $18 each. Gross profit on each machine after including factory service expense of 20% of direct costs was $3.50. The parts manufactured by B Co. Ltd. were sold to A Co. Ltd. at $8.10 per machine. The gross profit of B Co. Ltd. after including factory service expense of 20% of direct costs, was $1.40 per machine.

Administrative and general expenses of A Co. Ltd. were 85 cents per machine and of B Co. Ltd. were 60 cents per machine. Selling expenses incurred by A Co. Ltd. amounted to $1.15 per machine.

The A Co. Ltd. and the B Co. Ltd. could produce and sell up to 20% more machines than had been sold. For each 4% increase in volume over the present level, total factory service costs would increase 3% of the costs at the present level and total general and administration costs would increase 2% of the costs at the present level. Selling expenses vary directly with the number of units sold.

It was discovered that another company had infringed on the patent rights during 1949 and 1950 and the A Co. Ltd. and the B Co. Ltd. had sued and obtained a judgment awarding them the full amount of the profits lost by reason of the 8,320 units produced and sold by the infringing company.

Required:

Statement showing your calculation of the amount of the award to the A Co. Ltd. and to the B Co. Ltd.

A SOLUTION

A CO. LTD. and B CO. LTD.

Statement of Net Profit at Level of Production of 52,000 Machines

for the years 1949 and 1950

	A Co. Ltd.	B Co. Ltd.
Sales	$ 936,000	$ 421,200
Cost of goods sold:		
Material and labour	$ 628,333	$ 290,333
Overhead	125,667	58,067
Total cost of goods sold	$ 754,000	$ 348,400
Gross profit	$ 182,000	$ 72,800
Administrative expenses	$ 44,200	$ 31,200
Selling expenses	59,800	—
Total administrative and selling expenses	$ 104,000	$ 31,200
Net profit	$ 78,000	$ 41,600

STATEMENT OF NET PROFIT AT LEVEL OF PRODUCTION OF 60,320 MACHINES
(Increase 16%)

Sales			$ 1,085,760	$ 488,592
Cost of sales:				
Materials and labour	116% of $628,333		$ 728,866	
	116% of $290,333			$ 336,786
Overhead	112% of $125,667		140,747	
	112% of $ 58,067			65,035
	Total cost of goods sold		$ 869,613	$ 401,821
Gross profit			$ 216,147	$ 86,771
Administrative expenses	108% of $44,200		$ 47,736	
	108% of $31,200			33,696
Selling expenses	60,320 units @$1.15		69,368	—
	Total administrative and selling expenses		$ 117,104	$ 33,696
Net profit			$ 99,043	$ 53,075

A CO. LTD. and B CO. LTD.

CALCULATION OF THE AMOUNT OF THE AWARD

	A Co. Ltd.	B Co. Ltd.
Net profit at level of production of 60,320 machines	$ 99,043	$ 53,075
Net profit at level of production of 52,000 machines	78,000	41,600
Amount of award	$ 21,043	$ 11,475

EXAMINER'S COMMENTS

Some candidates did not realize that the 2% variation in general and administration costs is a rate per 4% increase in volume. Others, in considering the increased costs of the additional 8,320 units, ignored the effect of unit cost changes on the original 52,000 units.

THE TAX REVIEW

Melville Pierce, B.A., LL.B., Editor

[1954] MAY Part I

POSTPONING TAXATION BY INCORPORATING A BUSINESS

By Professor William G. Leonard, F.C.A.

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IT is widely known in business circles that a businessman who owns an unincorporated business of any size which is earning an income for him can effect an immediate reduction in his income tax payments by incorporating the business. Note the effect of the word "immediate". There may not be a total reduction, but merely a postponement. There is an immediate reduction because the rates of personal income tax are sharply graduated so that (using 1954 rates) any taxable income in excess of $25,000 is taxed at a rate higher than 50%. The rates of corporate income tax are 20% on the first $20,000 and 49% on anything over that amount. Furthermore, what was a single income before is now split into two incomes both of which attract taxation at relatively low rates by comparison with the "top bracket" rates on a single income of equivalent amount.

To illustrate how this works, let us take the case of an imaginary businessman John Smith. In example 1, let us imagine that he is a married man with no dependants other than his wife and owns an unincorporated business which earns him $52,000 a year. After deducting his marital exemption of $2,000, his taxable income is $50,000.

If we consult the table of 1954 tax rates, we find that his tax on the first $40,000 is $16,160 and on the remaining $10,000 is 55% or $5,500. This is a total tax of $21,660.

Now in example 2, let us imagine that his is an incorporated business named Smith Limited which pays him a salary of $27,000 as president and general manager, and the remaining $25,000 is left to accumulate in the business. Now we have two separate incomes.

Smith has a personal income of $27,000 and is taxable on $25,000 of it. According to the 1954 tax tables, the income tax on this is $8,660.

Smith Limited has an income of $25,000 only as Smith's salary is a deductible expense in measuring the income of the company.

On the first $20,000 it is taxed 20% or	$4,000
On the remaining $5,000 it is taxed 49% or	2,450
Total tax payable by the company	$6,450

The total tax immediately payable on both the incomes totalling $52,000 is $15,110 which is a net saving in current taxes of $6,550 as compared with example 1. Now if this were the whole story, there would be an obvious advantage in incorporation. But, in the long run, the story may be different. The greater part of the apparent saving is merely a postponement, not an absolute saving. We will illustrate this by a further example which we will call example 3.

In presenting example 3, we ask the reader to remember that whereas in the eyes of the law — for most purposes — John Smith Limited is a different "person" from John Smith himself, nevertheless in simple fact the company's sole purpose is to earn income for its principal shareholder, namely John Smith. If the company is successful and builds up an accumulation of earnings, the personal tax on those earnings is only postponed — it is not cancelled. It will be exacted whenever John Smith draws his earnings out of the business.

So in example 3, in order to demonstrate the extent of the postponement of taxation, we assume that the company instead of retaining its earnings pays it out immediately as a dividend to John Smith which dividend is taxed at 1954 rates.

The company's income is	$25,000
Out of this it pays income tax of	6,450
Net amount available for dividends is	$18,550

From example 2 we see that John Smith was previously taxable on $25,000, so on receipt of a dividend of $18,550 he now becomes taxable on $43,550.

As in example 1, his tax on the first $40,000 is $16,160 and on the remainder is 55% of $3,550 or $1,952.50.

Therefore, normal income tax is	$18,112.50
Sur-tax on investment income of $18,550 is 4% of ($18,550—$2,400) equals	646.00
Total income tax before dividend tax credit	18,758.50
Dividend tax credit is 20% of $18,550 equals	3,710.00
Net personal tax	15,048.50

If we add the company income tax $6,450, we arrive at a total of $21,498.50 which is approximately $150 less than the tax in example 1. While in this example it is slightly smaller, in other cases the tax on this basis might be slightly greater. My main point is that it does not differ to any significant extent from that in example 1.

Note Concerning Example 3

Recent amendments to the income tax law have made the comparisons shown in these examples considerably more favourable to shareholders than used to be the case. The dividend tax credit shown in example 3 is comparatively new.

Prior to 1949, no such credit was allowed.

For the years 1949 to 1952 the rate of credit was 10%.

For the taxation year 1953 the rate of credit was raised to 20%.

It may readily be seen that the postponement of taxes on such a scale is a terrific inducement for every growing business (whose principal financial need is for working capital to help it grow) to incorporate and to let the government help finance its expansion even if this means storing up a "day of reckoning" with the Tax Department until some future time when the

tax problem is bound to re-emerge. Often this day of reckoning if inadequately foreseen and not planned for may take such a form as to endanger the successful continuation of the business. Theoretically, on the other hand the day of reckoning may never come if the retained earnings of the company never have (i) to be withdrawn from the business or (ii) to be "capitalized" so as to attract taxation.

The Day of Reckoning

From the foregoing discussion, we can easily see why ever since the early days of income tax growing businesses have been eager to incorporate and postpone the full burden of their income tax payments until such time as the burden could be postponed no longer. The day of reckoning commonly came for personal businesses (such as John Smith Limited in the examples we have given) at the time of the death of the principal shareholder, John Smith. Suppose he had plowed back all of the earnings of John Smith Limited into expansion of the business and had not withdrawn any of its earnings as dividends. John Smith Limited would then have a large accumulation of "undistributed income" which had borne the company rate of tax but which still has to bear taxation as personal income at graduated personal rates at the time when the company pays it out to the shareholders as dividends. If John Smith lives up to his $25,000 of other income and does not leave his heirs enough cash to pay succession duties from sources other than the business, the only way they can find the necessary funds to pay the succession duties is (i) to draw the money out of the business or (ii) to sell the business if they can find a buyer. But if they try to draw the money out of the business to pay succession duties, the money becomes dividend income in their hands and added to their other income, this will place them in a very high income tax bracket. The amount left to them after income taxes may be insufficient to pay the succession duties. The combined impact of graduated succession duty rates and graduated income tax rates can create a problem impossible of solution.

So, in many cases, a problem was created which could not be solved except by the heirs selling their capital interest at a sacrifice price if they could find a buyer in order to be able to pay the succession duties on their inheritance. In the words of the Ives Commission Report, "In such a case the heirs may be obliged to sell the business, often to a larger competitor and in disadvantageous circumstances".

Note that this problem arises only with private companies whose shares are not readily marketable. In the case of an estate consisting of shares in a large public company whose shares are listed on the stock exchange, the heirs can easily sell or borrow money on some of the shares to obtain money with which to pay succession duties. Here, no special income tax problem arises. It is on the shareholders of small private (one man or one family) corporations that the strait-jacket closes.

To quote again from the Ives Commission Report, "the Commission was impressed with the fact that while the law treated shareholders of closely-held companies and those of public companies in the same fashion, there is a very real practical difference in the consequences".

Parliament to the Rescue

The special difficulties of private

companies have occasioned legislative action on each of three separate occasions.

(1) In 1930, legislation was introduced which in effect made it possible for a company to wind up, discontinue, or reorganize, and to distribute retained earnings earned prior to 1930 free of personal income tax. This right was withdrawn in 1934 effective as of July 3 of that year.

(2) In 1945, on the recommendation of the Ives Commission, Parliament enacted legislation under which "a private company" — defined as one with no more than 75 shareholders, exclusive of employees — might elect to pay a special tax on undistributed earnings on hand at the end of the 1939 year. The balance of these earnings, after payment of this special tax, would be free of further tax when distributed to the shareholders.

This provision "unfroze" the pre-1939 earnings at a rate of special tax which varied from 15% to 33% depending on the total amount of money involved but failed to provide a continuing remedy which might be applied to accumulations of earnings after 1939.

(3) In 1950, a new remedy was enacted which not only dealt with pre-1949 accumulations but devised a continuing form of partial relief which could be used with respect to earnings of 1950 and subsequent years.

A special tax of 15% could now be paid on the pre-1949 earnings after which the remaining 85% became tax free if distributed on winding up, discontinuance, or reorganization of the company but *not* if they are paid as ordinary cash dividends.

The continuing relief for post-1949 accumulations of earnings can be applied only to 50% of the company's earnings since that date and then only if two conditions have been fulfilled: —

(1) If the company has an accumulation of pre-1949 earnings it must have elected to pay the special tax on them before electing to pay the special tax on the permitted portion of post-1949 earnings.

(2) It must distribute as cash dividends an amount of post-1949 earnings equal to that on which it is electing to pay the special tax of 15%.

The effect of these provisions, in general, is that now private companies are able to arrange their affairs so that on the death of a principal shareholder, they can reorganize the company, pay a relatively low rate of tax, namely 15% on 100% of pre-1949 earnings and on 50% of post-1949 earnings, provided they pay the full personal rates on the other 50% and so have the remaining 85% of these earnings available to pay succession duties or to make other necessary arrangements for the continuation of the business as a going concern. Of course there is an even easier solution available if the principal shareholder has had the foresight to draw out cash dividends year by year for 50% of the company's post-1949 earnings and so avoid "lumping" the dividends into one year and raising his income into an unnecessarily high "tax bracket".

Articles and cases in *The Tax Review* are cited by reference to the year and Part in which the case or article appears. Two parts will be published each year: Part I comprises the issues of *The Canadian Chartered Accountant* from January to June, and Part II the issues from July to Dec.

RECENT TAX CASES

M.N.R. v. MacInnes

(*Exchequer Court of Canada, Thorson P., March 8, 1954*)

Married Persons — Transfer of Property by husband to wife — Property twice substituted therefor — Whether income from chargeable to husband — Strict construction — IWTA s. 32(2)

During the years from 1939 to March 1947 MacInnes made gifts to his wife of money and bonds to the value of $9,000, with which money she purchased bonds, later selling those and buying stocks, and then later selling the stocks and purchasing other securities, from which in 1948 she received income amounting to $2,606. The Minister invoked IWTA s. 32(2) and assessed the husband to income tax in respect of the wife's income from the said securities in that year. IWTA s. 32(2) provides that "where a husband transfers property to his wife . . . the husband . . . shall nevertheless be liable to be taxed on the income derived from such property or from property substituted therefor as if such transfer had not been made".

Held, affirming the ITAB (*sub nom 19* v. *MNR* [1951] Tax Rev. 205 (Mr. Fisher)), the income was not derived from the property transferred by the husband to the wife or from "property substituted therefor", within the meaning of those words in s. 32(2); it was derived from property substituted for the substituted property, and therefore s. 32(2) did not apply to authorize the assessment of the husband in respect of that income. Inasmuch as s. 32(2) imposes a tax liability only in exceptional circumstances it is essential to the imposition of tax thereunder that it should clearly apply to the facts of the case. It is well settled that a tax liability cannot be fastened upon a person unless his case clearly comes within the express terms of the enactment: it is the letter of the law that governs in a taxing Act. Moreover, the Court has no right to assume that a transaction is within the intention or purpose of a taxing Act if it does not fall within its express terms. There is no intention to tax other than that which its words express. *Connell* v. *MNR* [1946] Ex. C.R. 562, at 566; *Partington* v. *A.-G.* (1869) L.R. 4 H.L. 100, per Lord Cairns at p. 122; *Tennant* v. *Smith* [1892] A.C. per Lord Halsbury at p. 154.

Appeal dismissed

Stock Exchange Bldg. Corp. v. M.N.R.

(*Exchequer Court of Canada, Thorson P., March 11, 1954*)

Interest on Borrowed Capital — Bond discount — Underwriters' commission — Overdue interest — Whether interest payable thereon deductible — IWTA s. 5(1)(b)

Appellant company erected a building in Vancouver in 1929, and financed the construction by an issue of $550,000 first mortgage 6% bonds which provided that interest should be payable on overdue interest at 6%. The company defaulted in payment of interest after three years, but it was allowed a deduction for the full amount of interest payable, including interest on overdue interest, in all the years up to and including 1944. The bonds were issued at $99, i.e. at a discount of $1 per $100 bond, the issue being handled for appel-

lant by an underwriting firm which received a commission of $9 per $100 bond. For the years 1945 to 1948, both inclusive, appellant claimed deductions of the full amount of interest, including interest on overdue interest, payable on the bonds in those years, none of which was in fact paid, but the Minister disallowed any deduction for (1) interest on overdue interest, (2) interest referable to the discount granted on the issue of the bonds, and (3) interest referable to the commission paid the underwriters of the bond issue. Appellant appealed to the ITAB (Mr. Fisher), [1953] Tax Rev. 33, which held that no deduction was allowable under IWTA s. 5(1)(b) for (1) interest on overdue interest and (2) interest referable to the discount granted on the issue of the bonds, but that a deduction was allowable for interest referable to the amount of the underwriters' commission. Appellant appealed against the disallowance of the deduction of the interest on overdue interest and the Minister cross-appealed against the allowance of the deduction of interest on the underwriting commissions.

Held, neither was an allowable deduction. Inasmuch as interest on borrowed capital is not an allowable deduction from income except as s. 5(1)(b) permits, the ambit of that exception must not be extended to cover cases that do not come within its express terms: *Lumbers* v. *MNR* [1943] Ex. C.R. 202, per Thorson P. at p. 211. To be entitled to a deduction under s. 5(1)(b) it is therefore necessary to show that the overdue interest was capital, that it was borrowed, and that it was used in the business to earn income. In none of the particulars mentioned did the overdue interest qualify: it was not "capital", which word imports an asset in some form capable of being or becoming a source of income, as distinct from the obligation or liability incidental to it (*Baymond Corp.* v. *MNR* [1945] Ex. C.R. 11, per Thorson P. at p. 15): it was not "borrowed" from the bondholders, the relationship between the appellant and the bondholders in respect of the unpaid interest and the liability to pay interest on it not being that of borrower and lender but that of debtor and creditor (*McCool Ltd.* v. *MNR* (Sup. Ct. of Can.) [1950] S.C.R. 80, applied.) Finally, the amount paid the underwriters for their services in selling the bonds for appellant was not "used in [appellant's] business to earn the income", as required by s. 5(1)(b); it was rather a cost to appellant of its financing and as such was a capital cost and therefore not properly deductible as an operating expense: *Montreal Coke & Mfg. Co.* v. *MNR* [1944] A.C. 126, applied.

Moreover, since the interest on the overdue interest was not actually paid it was not deductible in any event: *Trapp* v. *MNR* [1946] Ex. C.R. 245 per Thorson P. at p. 262.

Appeal dismissed; cross-appeal allowed

M.N.R. v. Topham

(*Exchequer Court of Canada, Cameron J., March 8, 1953*)

Farmers and Fishermen — Election to average income for five years — Filing of returns for averaging years within prescribed time — A condition precedent to election — ITA 1948 s. 39(1), 40

Topham, whose chief source of income was farming, filed his income tax returns for 1946, 1947 and 1949 within the time limited by the statutes for so doing but he did not file his tax return for 1948 until some weeks after the last

day fixed by the Act for filing it and a penalty for late filing under IWTA s. 77 was imposed by the Minister and paid. In all of the years mentioned Topham had taxable income. Within the time limited by ITA 1948 s. 39 Topham filed an election to average his income for the four years mentioned, but the Minister rejected the election on the ground that Topham, by failing to file his tax return for 1948 within the time specified by the Act (IWTA s. 33; ITA 1948 s. 40) was disentitled to elect to average his income for the four years in question under s. 39, which authorizes an election if, *inter alia,* the taxpayer has filed returns of income for preceding years as required by Part I of the Act.

Topham's appeal to the ITAB was allowed by Mr. Fisher [1952] Tax Rev. 135. The Minister appealed to the Exchequer Court of Canada.

Held, allowing the Minister's appeal, Topham did not file returns of income for the years of the averaging period "as required by Part I" within the meaning of those words in ITA 1948 s. 39. It is provided in Part I (*viz.* s. 40) that in the case of an individual who has taxable income in a taxation year a return of his income shall be filed with the Minister in prescribed form and containing prescribed information on or before April 30 in the next year. The latter requirement of s. 40 cannot be treated as mere surplusage in order to avoid what is contended to be an anomalous result. *MNR* v. *Nielsen* (Angers J.) [1953] Tax Rev. 28, agreed with. Topham is claiming the benefit of a relieving enactment and it is a well established rule that an exemption provision in a taxing Act must be strictly construed, that is to say, a taxpayer who claims an exemption from income tax must bring his claim squarely within the provisions of the exempting section; he must show that every constituent element necessary to the exemption is present and that every condition required by the exempting section has been complied with: *Lumbers* v. *MNR* [1943] Ex. C.R. 202, per Thorson P. at p. 211 followed.

Appeal allowed

Editor's Note: In this decision Cameron J. follows Angers J. in *Nielsen* v. *MNR, supra,* in holding that under ITA 1948 s. 39 a return is not filed "as required by Part I" unless it complies with both requirements of s. 40, *viz,* as to the form of return and as to the time of filing. Section 40 does not, however, require any return to be filed by an individual for any taxation year for which no tax is payable unless the Minister demands that a return be filed. Hence it cannot be said that a return filed by an individual for a year for which no tax was payable is filed as required by Part I unless the Minister has demanded it. Cameron J. mentions in his judgment that counsel for the Minister admitted in argument that a farmer who had no taxable income for a year could come within the averaging provision of ITA 1948 s. 39 by filing a return for that year at any time before making his election to average. But in view of the above it must be doubted whether this is really so.

Under ITA 1948 s. 39 it is a condition precedent to an election that the taxpayer file returns of income as required by Part I for the four years immediately preceding the year of averaging. Since, according to this judgment and that of Angers J., s. 40 lays down the requirements as to the filing of returns, it would appear to follow that a taxpayer who has no taxable income in any year within a five year period cannot average for that period since he cannot comply with ITA s. 39, viz., file returns for all of such years "as required by Part I", there being no requirement to file a return for a year of no taxable income. If that is so, it follows that under ITA 1948 s. 39 a farmer can only elect to average for a period of five successive years in each of which he had a taxable income.

ITA 1948 s. 39 was, however, amended in 1953 to permit a taxpayer to elect to average for the year of averaging and the four im-

mediately preceding years *for which* he had filed returns of income as required by Part I if (subsection (3)) the first of such years is not earlier than the sixth year before the year of averaging. It is therefore no longer necessary that the taxpayer have a taxable income in each of five successive years in order to elect, but on the other hand the election must be for the year of averaging and the four preceding years in which the taxpayer had taxable incomes, the earliest of which was not more than six years prior to the year of averaging. The exclusion of years of no taxable income from the averaging period will, of course, prevent a taxpayer from claiming marital and other personal allowances to the extent that they exceed his actual income in any year, but it will also have other undesirable consequences from the point of view of the taxpayer.

INCOME TAX APPEAL BOARD CASES

Fabio Monet Esq., Q.C. (Chairman) Cecil L. Snyder Esq., Q.C. (Assistant Chairman) W. S. Fisher Esq., Q.C. and R. S. W. Fordham Esq., Q.C.

Kennedy v. M.N.R.

Farmers & Fishermen — Averaging Income — Losses sustained in last two years of averaging period — Whether last year's loss to be taken into account — Construction of statutes — Parliamentary intention — Debates in House of Commons relevant — ITA (1950) s. 26(1) (d), 39(1)(a)

Kennedy, a farmer, elected to average his farm income for the five years 1946 to 1950 under ITA s. 39, his income from farming for the five years being $16,032 in 1946, $17,353 in 1947, $6,342 in 1948, a loss of $4,249 in 1949 and a loss of $17,734 in 1950. Kennedy contended that his average income for the five years should be the average of the above amounts, that is, taking into consideration the losses sustained both in 1949 and in 1950, but the Minister contended that in virtue of s. 39(1)(a) the loss sustained in 1950 must be dealt with in accordance with the provisions of s. 26(1)(d), i.e., be applied first against the income of the previous year and the remainder against income of the succeeding years, and since Kennedy had no income in the previous year, he contended the 1950 loss could not be taken into account in averaging the income of the five years in question but must be carried forward to the succeeding years.

Held (Mr. Fisher), the appeal must be allowed. Section 39 is a special provision for averaging the incomes of farmers and fishermen over a five-year period, where as s. 26(1)(d) is concerned with the taxable income of a taxpayer determined each year. The average income for a five year period requires that losses as well as profits be taken into account. This construction of s. 39 is supported by statements made in the House of Commons when s. 39 was being enacted, and the contrary construction would lead to the anomalous situation that a farmer who sustained losses in the first two years of the period would be in a better position than one who sustained losses of the same amount in the last two years of the averaging period.

B.C., Jan 13/54 *Allowed*

Stringham v. M.N.R.

Farmers and Fishermen — Averaging income — Whether averaging excluded for year of loss — "Chief source of income" — Meaning of — Parliamentary intention — ITA 1948 s. 39

Stringham owned a ranch and leased ranch lands from other ranchers, pur-

chased livestock each year, and put them out to fatten on his grazing lands until they were ready for market. Some cattle he put into feeder lots where they were fattened on grain more rapidly than on grazing lands. In 1948 he sold his ranch lands but continued to buy and graze cattle for sale on leased lands. In 1949 he sustained a loss on his operations and he elected to average his income for the years 1946 to 1949 as authorized by ITA s. 39. The Minister rejected the election on the ground that Stringham's chief source of income for 1949 was not from farming.

Held (Mr. Fisher), the appeal must be allowed.

(1) Appellant's operations during 1949 constituted "livestock raising" within the meaning of that phrase in the definition of "farming" contained in ITA 1948 s. 127(1)(o) even though he did not own the land on which those operations were carried on.

(2) The words "chief source of income" in s. 39(1) could not be interpreted as meaning the source from which the taxpayer's principal income was derived in a year because such an interpretation would frustrate the obvious intention of Parliament in enacting the averaging provisions since so construed the section could not be invoked for a year of loss. Alternatively the words "chief source of income during a taxation . . . year and the four immediately preceding years" in s. 39 were satisfied if the taxpayer's chief source of income for the whole of the averaging period was farming, which was the case here.

Alta, Jan 11/54 *Allowed*

Lawrence v. M.N.R.

Farmers & Fishermen — Election to average for five years — Whether farming chief source of income for averaging period — Income from other source exceeds farm income for one or more years — ITA 1948 s. 39

Lawrence elected to average his income for the five years 1947 to 1951 under ITA 1948 s. 39 on the ground that his chief source of income during those five years was farming. In each of the five years he operated his farm at a profit and also derived income in each of such years from a land-clearing and brush-cutting business which he carried on in partnership with another person. In 1947 and 1948 his income from the other business exceeded his farming income; in 1949, 1950, and 1951 his farming income exceeded his income from the other business, and for the whole five years his farming income exceeded his income from the other business by some $7,500. The Minister rejected Lawrence's election to average under s. 39 on the ground that his chief source of income during the years concerned was not from farming alone.

Held (Mr. Fisher), since Lawrence's income from farming exceeded his income from the other business in 1951 and in the five years of the averaging period his chief source of income in 1951 and the four year period immediately preceding 1951 and therefore for the whole of the five-year period was farming, and he was thus clearly within the terms of s. 39 and entitled to average.

Alta, Feb 22/54 *Allowed*

Bekkerus v. M.N.R.

Farmers & Fishermen — Election to average — Chief source of income — Meaning of — A question of fact — Income of averaging period determines right to average — ITA 1948 s. 39

Bekkerus had income from farming in 1947, 1948, 1949, and 1951, but sustained a loss on his farming operations

in 1950. In 1948, 1949, 1950, and 1951 he had income from other sources, and in each of the latter three years his income from these other sources exceeded his income from farming, though his total income from farming for the five years (*viz.* $9797) exceeded his total income from the other sources for the same period (*viz.* $8730). The taxpayer filed his annual returns on time and elected to average his income for the five year period under s. 39. The Minister refused to permit averaging, however, on the ground that his chief source of income for the years of average was not from farming.

Held (Mr. Fisher), under ITA 1948 s. 39 it is not necessary that the taxpayer's chief source of income in each of the years of the averaging period be farming (or fishing) in order to permit of averaging; it suffices if his chief source of income for the whole duration of the five year period be farming (or fishing), as is the case here. Under s. 39 the Minister has no power to rule that a taxpayer's chief source of income is not farming but a combination of sources, that power being authorized only for the purposes of s. 13. What is a taxpayer's chief source of income is a question of fact, and here where the farmer had a larger income from farming than from all other sources combined for the five year period and was in addition a bona fide farmer throughout the period, the falling off of his farm income in the last three years of the period being due to weather conditions, it must be found that his chief source of income during the period was farming and that he was entitled to average.

Alta, Feb 24/54 *Allowed*

140 v. M.N.R.

Farming Losses — Farming conducted always at a loss — Whether chief source of income — ITA s. 13

Appellant, who enjoyed a private income, purchased a farm of 47 acres in 1945, to which he subsequently added 83 acres. By 1949 he had invested $65,000 in the farm and had substantially increased its productivity. He lived on the farm three months of each year and testified that during the balance of the year he spent most of his working days at his office (where he held a sinecure as vice-president of a private company) in maintaining his farm records and accounting. He kept two regular employees at his farm and hired extra help when needed. Farming authorities testified that it would take about 8 to 10 years for appellant's farm to operate at a profit. The farming operations resulted in a loss of $8,485 in 1947, $7,540 in 1948, $5,860 in 1949, and $7,570 in 1950. Appellant's income from other sources, including stocks, bonds, and patents, was $28,00 in 1949 and $29,000 in 1950. In his tax returns for those years he deducted his farm losses sustained in those years but the Minister invoked ITA s. 13 and ruled that appellant's chief source of income was not farming or a combination of farming and some other source and that only one-half of his farm losses for each year was properly deductible.

Held (Mr. Fordham), the appeal must be dismissed. The evidence did not support appellant's contention that farming operations constituted one of his chief sources of income. Rather he was primarily a business man and farming was a secondary pursuit. Further, whether or not he operated the farm with a reasonable expectation of profit is irrelevant under ITA s. 13, which speaks of "chief source of income" and not of "chief occupation" as did IWTA s. 10. Nor was there support for his submission that his farm was a chief source of income as being an investment like his other invest-

ments: farming had not become his chief source of income and was still mainly a cause of expense to him whatever its future prospects. *McLaughlin's Executor* v. *MNR* (Ex.) [1952] Tax Rev. 188; *Petschek* v. *MNR* (ITAB) [1952] Tax Rev. 149; *76* v. *MNR* (ITAB) [1953] Tax Rev. 55, distinguished.

Que, Jan 11/54 *Dismissed*

Eaton v. M.N.R.

Farmers & Fishermen — Farming loss — Farming not chief source of income in loss year — Deduction restricted to one-half loss — ITA 1951 s. 13

Appellant was a farmer in Alberta but had income from other sources as well. He sustained losses in his farming operations in the great majority of years, and in each of the years 1947 to 1951 inclusive.

Held (Mr. Fisher), notwithstanding that appellant's occupation and main activities throughout 1951 had to do with farming, farming was not his chief source of income in that year since he received no income from farming in that year, and accordingly he was not entitled to deduct his whole farming loss from his other income in that year but only one-half of his farming loss not exceeding $5000, as permitted by ITA 1951 s. 13.

Feb 23/54 *Dismissed*

Editor's Note: Section 13 provides in effect that one-half of a farming loss up to $5000 may be deducted from a taxpayer's other income where his chief source of income is not farming (or farming and some other source). It is held here apparently that a chief source of income is the source from which more income is derived than from any other source (or perhaps from all other sources). It follows therefore that under s. 13 only one-half of a farming loss not exceeding $5000 can be deducted from other income of the same year and that the balance of the loss can only be applied against the farming income of the taxpayer for the previous year and the five succeeding years under s. 27(1)(e) and then only if the farming loss is a "business" loss, which condition may conceivably exclude farming losses sustained by persons who carry on farming as a hobby only. Under s. 39 a person whose chief source of income is from farming during the taxation year and the first four of the six immediately preceding years in which he had taxable income can elect to average his taxable income from all sources for those five years but not taking into account a business loss sustained in the year following the taxation year. Such at least appears to be the result of the cases on these various provisions.

115 v. M.N.R.

Consideration for covenant not to compete — Whether agreement states facts correctly—ITA (1950) s. 24A

In July 1935 appellant, the controlling shareholder of company A, agreed to sell his shares to certain persons for $600,000, to be payable $540,000 by the purchasers and $60,000 by the company. Pursuant thereto company A entered into a contract with appellant whereby, in consideration of his covenant not to engage in the lobster business in a specified area the company covenanted to pay him $60,000 over 20 years at the rate of $3,000 a year. Subsequently company A sold all its assets to company B, and by a supplementary agreement between appellant, company A and company B, appellant released company A from the above obligation and in consideration of a covenant by company B to pay him the balance of the $60,000 still owing by company A covenanted with company B not to engage in the lobster business in the specified area for 20 years. Appellant was assessed to income tax in respect of the sums paid him by company B pursuant to the above covenant in 1949 and 1950. This appeal followed, and it was stated on the appeal that none of the parties mentioned was at any relevant

time engaged in or interested in the lobster business, and that appellant's covenant was simply inserted in the agreement to indicate a consideration for the covenants by companies A and B to pay him a total of $60,000 over 20 years.

The Minister relied on *ITA* s. 24A, which provides (in part):

> An amount received by one person from another
> (a) during a period while the payee was an officer of, or in the employment of, the payer, or
> (b) on account or in lieu of payment of, or in satisfaction of, an obligation arising out of an agreement made by the payer with the payee immediately prior to, during or immediately after a period that the payee was an officer of, or in the employment of, the payer,
>
> shall be deemed . . . to be remuneration for the payee's services . . . unless it is established that, irrespective of when the agreement, if any, under which the amount was received was made or the form or legal effect thereof, it cannot reasonably be regarded as having been received . . .
> (iii) in consideration or partial consideration for covenant with reference to what the officer or employee is, or is not, to do before or after the termination of the employment.

Held (Mr. Monet), the court was satisfied on the evidence that the amount of $60,000 which company A agreed to pay appellant was not to be paid him in consideration of his covenant not to engage in the lobster business, and the same applied to the agreement by company B to pay him moneys. Accordingly appellant's case fell within exception (iii) to s. 24A.

Sep 16/53 *Allowed*

Twin City Industrial Equipment Ltd. v. M.N.R.

Capital Cost Allowances — Leasehold interest of manufacturer in spur line — Rate of allowance — Applicable class — Cl. 1(h) not applicable — Cl. 13 applicable

In 1948 a railway industrial spur was constructed on lands which appellant company leased from the City of Port Arthur. The spur line was laid from material supplied by the C.N.R., on a hard cinder roadbed constructed at appellant's cost, but the materials remained the property of the C.N.R. By agreement with the C.N.R. appellant became lessee of the spur line at a specified rental, which was terminable by the C.N.R. at any time on two months' notice without compensation to appellant. In its return for 1950 appellant claimed a capital cost allowance in respect of its expenditure on the spur line at the rate of 20% under IT Regs Sch. B, Cl. 13 on the ground that it was in respect of a leasehold interest, but the Minister contended that it fell under cl. 1(h) "a railway track and grading that is not the property of a railway system".

Held (Mr. Fordham), as the railway was the property of the C.N.R. and the grading the property of the city of Port Arthur it was excluded from cl. 1(h) and the only other applicable class was cl. 13 as contended by appellant.

Ont, Nov 17/53 *Allowed*

Lamb v. M.N.R.

Capital Cost Allowances — Leasehold Interest — Purchase of deceased lessee's business — Not cost of acquiring leasehold — ITRegs, Sch. B, Cl 13

Lamb, a dentist, was given to expect that he would be granted a lease of office space in a building if he purchased the practice of the previous lessee, a dentist, who had died. With that purpose in mind Lamb purchased the whole of the deceased dentist's business from the latter's widow for $5,000, of which $3,250

was specified as the price of equipment and $1,750 for goodwill and rights in the lease. The lease of the premises granted Lamb by the building owners was for one year at a monthly rent of $110. Lamb sold the equipment purchased by him as aforesaid, realizing $3,200, but he considered the unrecovered amount, viz. $1,800, as being the cost of obtaining the lease, and in his return for 1951 claimed a deduction of one-fifth of that amount as the allowance permissible under Class 13 of Sch. B of the ITRegs in respect of the capital cost to him of a leasehold interest.

Held (Mr. Fordham), appellant did not purchase a leasehold interest but the opportunity to obtain a foothold in the building and thus acquire first chance of obtaining a lease of premises therein. The deduction was therefore not allowable.

Que, Dec 10/53 *Dismissed*

131 v. M.N.R.

Capital Cost Allowances — Arms length purchase of assets followed by non arms length sale — Valuation established by purchase — ITA 1948 s. 20(1) and (2)

In November 1948 Y, who was in the trucking business, obtained an option to purchase 31 trucks together with certain franchises and highway transport licences from a trucking firm for $40,000, of which amount $39,852 was for the trucks and the remainder for the licences and goodwill. Y spent a good deal of time before exercising the option in soliciting new customers and seeking new business on the strength of the licences to be obtained, and on January 3, 1949 the sale was executed. On February 2 Y transferred all the said assets for $50,000 to appellant corporation which had been incorporated two weeks earlier and of which he became the majority shareholder. The reason for the increase in the price was explained as being the result of the increased value of the licences as a result of Y's efforts. In assessing appellant to tax, however, the Minister allowed capital cost allowances in respect of the trucks on a capital cost of $31,882 for 1949 and $30,444.34 for 1950, purporting to do so under ITA 1948, secs. 11(1)(a), 20(1) and (2) and ITRegs s. 1100. The explanation for placing the capital cost of the trucks at this amount was somehow connected with the increase of $10,000 in the sale price of the assets between the date of the option and the date of the sale to appellant company. It was not disputed that the second sale was a non arms length transaction.

Held (Mr. Fordham), inasmuch as the first sale was an arms length transaction which fixed the capital cost of the trucks, capital cost allowances ought to have been allowed on that amount. The value of the trucks was not affected by the increased value placed on the licences.

Dec 1/1953 *Allowed*

134 v. M.N.R.
135 v. M.N.R.

Capital Cost Allowances — Logging Equipment — Retroactive increase in rate — Whether applicable to corporation where accounts already made up — ITRegs 1100(4)

134 v. *MNR*

Appellant was a private company whose financial year ended on December 31 of each year. In its income tax return for 1951, appellant claimed a capital cost allowance on mechanical equipment acquired for logging operations at the rate of 20%, that being the amount actually charged in its accounts and reflected in its financial statements at that time. Prior to May 9, 1952 the maxi-

mum rate of capital cost allowance for such equipment was 20% under the Income Tax Regulations, but on May 9, 1952 the rate was increased to 30%, and the increased rate was made retroactive to the 1950 taxation year. (Order-in-council P.C. 2702 of May 9/52 [1952] Tax Rev. 178.) The amending order-in-council was published in the Canada Gazette on May 28, 1952 and in June appellant filed its tax return for 1951. On August 1, appellant notified the Minister that it proposed to file an amended return for 1951, and alterations were made to its books of account and financial statements for 1951 in order to comply with ITReg 1100(4) which restricts capital cost allowances claimed by a corporation to the amount shown in its books of account and reflected in its financial statements, i.e., the amount of the deduction shown therein was increased from 20% to 30%. By notice of assessment dated August 25 appellant was assessed to tax on the footing of capital cost allowance at 20% only. Appellant's amended return claiming capital cost allowance at 30% was not filed until September 1952.

Held (Mr. Fisher), inasmuch as the increased rate was made retroactive to 1950, appellant was entitled to the benefit of that rate in 1951. It would be both absurd and discriminatory if the increased rate could be availed of only by those who claimed higher allowances in their accounts than the regulations permitted and by those who delayed in making up their accounts. Such could not be the intention of Parliament.

Dec 15/53 *Allowed*

135 v. *MNR*

The question at issue in this appeal was similar to that which was dealt with in *134* v. *MNR, supra,* except that the taxation year under assessment was 1950, appellant's financial year ending on March 31st in that year, and its return for that year was filed at the end of 1950, in which capital cost allowance on mechanical logging equipment was claimed at 20%. Following the retroactive increase in the rate to 30% in 1952 appellant altered its books of account and financial statements for 1950 to show capital cost allowances on the equipment at 30% and it then made claim for an additional tax deduction, which was rejected by the Minister for the reasons stated in the appeal of *134, supra.* Mr. Fisher allowed the companys' appeal for the reasons stated in the appeal of 134.

Dec 15/53 *Allowed*

Editor's Note: The report of this decision does not state whether or not the appellant was assessed for 1950 prior to the filing of its claim in 1952 for increased capital cost allowance, and, if assessed prior to the date of the new claim, whether or not it filed an objection to the assessment within the time prescribed. In the appeal of *134* the company was assessed prior to the filing of its amended return but objection to the assessment was made within the time allowed by the Act for so doing.

Sibbitt v. M.N.R.

Capital Cost Allowances — Non-arms-length transaction — Husband and wife partners — Sale of partnership interest in depreciable property to surviving partner — ITA s. (20)(2) (1950)

Prior to May 12, 1949 appellant and his wife as partners purchased a creamery business for $6,000. On May 12 they entered into a separation agreement and on the same day the wife sold her husband her one-half interest in the creamery for $16,000. In 1950 the husband claimed capital cost allowances in respect of the creamery on the basis of the $16,000 paid by him to his wife. The Minister, invoking ITA s. 20(2), refused to allow the deduction.

Held (Mr. Fisher), inasmuch as the creamery which belonged to one person after the commencement of 1949 had by the above transaction between a husband and wife become vested in appellant, s. 20(2) applied, and appellant's claim must be rejected.

Ont, Jan 18/54 *Dismissed*

Checker Radio Taxi Ltd. v. M.N.R.

Capital Cost Allowances — Radio receiving and transmitting equipment installed in taxis — Subject to 25% rate — ITRegs Sch B, cl. 9(c) and (d), cl. 10(a)

Appellant company, a taxicab operator, installed radio receiving and transmitting equipment in seven of its cabs, and it was its practice on disposing of a cab to remove the radio equipment and instal it in another cab. In assessing appellant for 1952 the Minister would only allow capital cost allowances on the radio equipment under class 9(c) and (d) *viz* "radio transmission equipment", "radio receiving equipment that is used in conjunction with radio transmission equipment", for which the maximum allowable rate is 25%, instead of under class 10(a) *viz* "automotive equipment . . .", for which the maximum rate is 30%, the latter rate being applied to the cabs only. Appellant had other cabs which were not radio equipped.

Held (Mr. Fordham), as the radio equipment was readily detachable and not an integral part of a cab as such capital cost allowances were properly allowed at the 25% rate.

Ont, Mar 17/54 *Dismissed*

Home Oil Co. v. M.N.R.

Depletion Allowance — Oil producing company — Whether depletion calculated only on profit from producing wells or on net profit of producer from all wells — ITA (1949-50) s. 11(1)(b); ITRegs (1949-50) 1201(2) and (4).

Appellant company was in the oil producing business, and in computing its income for 1949 and 1950 it claimed a depletion allowance under ITA s. 11 (1)(b) and ITRegs 1201(1) and (4) based on its actual profits from each of its producing wells, i.e., without deducting from the aggregate of such profits its losses sustained on other wells, development expenditures and the applicable proportion of general and administrative expenses not related to the company's producing wells. The Minister however would allow depletion allowances only on the company's net profits from all its wells, i.e. after deduction of those amounts.

Held (Mr. Fisher), the Minister was right and the company's appeal must be dismissed: *York Oils Ltd.* v. *MNR* (Mr. Fordham) [1953] Tax Rev. 167 followed.

Alta, Feb 3/54 *Dismissed*

Goldman v. M.N.R.

Trusts & Estates — Direction in will to carry on business — Income payable to life tenant, remainder to others — Right of executors to deduct depreciation in computing profits — Whether life tenant taxable thereon — ITA 1948, s. 58(4) and (5)

By his will testator gave the residue of his estate to his widow and son as executors and trustees to, *inter alia,* continue his partnership in a certain business until his wife's death and to pay her for her life the net income derived by his estate from such partnership and upon the death of his wife to transfer his interest in the partnership to the surviving partner or, if he should predecease the wife, to divide the residue of the estate amongst his surviving children. On the testator's death his execu-

tors continued the partnership business with the surviving partner, and in accordance with the practice of the partnership prior to testator's death, calculated the profits thereof after making a deduction for depreciation, the balance being distributed to the partners as their interest entitled them. At no time were any moneys representing depreciation allowances paid to the wife. In assessing the wife for 1949 one-half of the depreciation allowance deducted by the partnership in ascertaining its profit for that year was added to the wife's income. ITA 1948 s. 58(5) provides that such part of the income of a trust or estate without any deduction for depreciation allowances as was payable to a beneficiary in a year shall be included in computing the latter's income whether or not it was actually paid, and s. 58(6) provides that an amount shall not be considered to have been payable in a taxation year unless it was paid in that year to the beneficiary or he was entitled in that year to enforce payment thereof.

Held (Mr. Fordham), the trustees of the will had the right to deduct a reasonable depreciation allowance in computing the profits of the partnership business, and having done so the beneficiary could not successfully demand payment to her of funds set aside by the executors for depreciation. As the wife neither received any of such moneys nor was entitled to enforce payment to her of any such moneys, she was not chargeable to income tax in respect of them. *Re Crabtree, Thomas* v. *Crabtree* (1912) 106 L.T. 49; *Re Rose* [1940] 1 DLR 139 (N.B.); *Re Robertson* [1951] OWN 332, applied.

Sask, Nov 3/53 *Allowed*

Flynn v. M.N.R.

Trusts and Estates — Life tenant or residuary legatee in usufruct — No right to capital cost allowance re estate income — ITA (1951) s. 58(5), (6A)

Under his wife's will Flynn was the residuary legatee in usufruct of her property for his lifetime, and her children were bequeathed the bare ownership with rights to the property after the usufruct came to an end. Flynn was also executor of the will. In 1951 the income from the estate was $4,258. Flynn, however, reported only $2,369 as his income therefrom, asserting a right to a capital cost allowance of $1,875 on the depreciable assets of the estate The Minister disallowed the deduction claimed. ITA s. 58(5) provides that the income of an estate without any deduction for capital cost allowances shall be chargeable to the beneficiaries to whom it is payable, and s. 58(6A) provides that a beneficiary with a contingent or absolute right to the property of the estate in the future is entitled to such part of the capital cost allowances as the estate may allot him.

Held (Mr. Fordham), appellant was a residuary legatee in usufruct without right to any part of the property of the estate in the future and therefore was barred by s. 58(6A) from any claim to capital cost allowance.

Que, Jan 12/54 *Dismissed*